SC93719

IN THE
Supreme Court of Missouri

DANIEL B. NICKELL,

Plaintiff-Appellant,

v.

MICHAEL F. SHANAHAN, SR., ***et al.***

Defendants-Respondents.

On Appeal from the Circuit Court of St. Louis City, Missouri, Division 31, Honorable Joan L. Moriarty

---

JOINT SUBSTITUTE BRIEF OF RESPONDENTS KENNETH E. LEWI, CROSBIE E. SAINT, GERHARD PETZALL, ESQ., AS PERSONAL REPRESENTATIVE OF THE ESTATE OF THOMAS J. GUILFOIL, EARL W. WIMS, MICHAEL F. SHANAHAN, JR., GARY C. GERHARDT, STEVEN J. LANDMANN, DAVID D. MATTERN, AND GERALD A. POTTHOFF

Jim J. Shoemake, #19695
Eric M. Walter, #47297
E. Calvin Matthews IV, #58278
Guilfoil Petzall & Shoemake, L.L.C.
100 South Fourth Street, Suite 500
St. Louis, Missouri 63105
Telephone: (314) 241-6890
Facsimile: (314) 241-2389
Email: JJS@gpslegal.com
Email: EMW@gpslegal.com
Email: ECM@gpslegal.com

Attorneys for Defendants/Respondents Kenneth E. Lewi, Crosbie E. Saint, and Gerhard Petzall, Esq. as Personal Representative of the Estate of Thomas J. Guilfoil

Richard E. Greenberg, #37916
Wendy S. Menghini, #51381
Erwin O. Switzer, #29653
Michael A. T. Schwalbert, #63229
Greensfelder, Hemker & Gale, P.C.
10 S. Broadway, Suite 2000
St. Louis, Missouri 63102
Telephone: (314) 241-9090
Facsimile: (314) 241-8624
Email: REG@greensfelder.com
Email: WMS@greensfelder.com
Email: EOS@greensfelder.com
Email: MS@greensfelder.com

Attorneys for Defendant/Respondent Earl W. Wims

[Additional counsel listed on signature page]

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Other Authorities

Rules

Constitutional Provisions

SUMMARY AND INTRODUCTION

Plaintiff's lawsuit can only be brought as a derivative claim, mandating affirmance of the Circuit Court's dismissal. All parties agree that the settled, general rule is that a breach of fiduciary duty claim against corporate officers and directors must be brought as a derivative action on behalf of the corporation. Individual shareholders have no standing to maintain an action in their own right. The parties also agree that Missouri recognizes a limited exception. That exception only applies when the alleged injury to the complaining stockholder is distinct from that suffered by other stockholders. Plaintiff's Petition seeks recovery for an injury allegedly incurred in the same way by every shareholder of Engineered Support Systems, Inc. ("ESSI"), so the exception does not apply here.

Plaintiff's challenge founders on two essential points, either one of which mandates affirmance of the trial court's dismissal on the basis that Plaintiff's claim can only be brought derivatively. First, Missouri cases (whose law controls) state that when a plaintiff alleges that shareholders as a whole were injured by the alleged conduct (as is undisputed here), the claim must be brought as a derivative claim. *See, e.g., Centerre Bank of Kansas City, N.A. v. Angle*, 976 S.W.2d 608 (Mo. App. 1998); *Dawson v. Dawson*, 645 S.W.2d 120 (Mo. App. 1982). Plaintiff argues that the cases do not mean what they say or should not be followed. Second, even without that bright-line test, the nature of the claim here is one in which any alleged harm was incurred by ESSI and ultimately its successor, DRS Technologies, Inc. ("DRS").

Even though Plaintiff now contends that he has brought a non-derivative claim, he originally brought his claim as a derivative claim in federal court, alleging that harm was incurred by DRS, the company that bought ESSI. Plaintiff alleged that DRS was damaged by paying **too much** for ESSI stock. Thus, Plaintiff alleged that the "victim" was DRS, not the ESSI shareholders as a whole. Now Plaintiff has reversed course. He alleges essentially the same facts but now asserts that DRS paid **too little.** Plaintiff cannot have it both ways.[1]

Plaintiff's first characterization of his claim—as a derivative claim alleging that DRS was injured—was the right one, at least from a procedural viewpoint. Plaintiff's theory is that Defendants were overcompensated by backdated stock options which Plaintiff alleges in this instance were improper. Overcompensation claims are derivative claims. The happenstance of a subsequent merger does not change the nature of Plaintiff's claim.

Plaintiff makes alternative arguments to overcome these obstacles. He tries to recast his injury as "direct." But none of the cases allowing direct claims involve alleged harms remotely similar to Plaintiff's alleged class-wide harm. Moreover, in his effort to create a "direct" injury, Plaintiff relies exclusively on the idea that he was misled regarding the relevant facts surrounding the merger vote. Such a purported claim would clearly fall under a misrepresentation cause of action. The Circuit Court did not

[1] Plaintiff may have reversed course as a result of selling his DRS stock, depriving him of standing to bring a derivative claim.

dismiss Plaintiff's misrepresentation claim (Count IV), but rather Plaintiff voluntarily dismissed it. His argument that he was deprived of his right to vote in an informed manner is a misrepresentation claim. His argument that he suffered a "direct fraud" as a result of misinformation provided by Defendants is a misrepresentation claim. Plaintiff had a remedy for a purported misrepresentation, but chose not to pursue that claim. He should not be permitted to resurrect it on an appeal from different claims.

The trial correctly understood that Plaintiff's claim can be brought only as a derivative claim. The trial court judgment should be affirmed.

STATEMENT OF FACTS

This brief is filed on behalf of the following Defendants/Respondents, who are "ESSI Defendants": Kenneth E. Lewi, Crosbie E. Saint, Gerhard Petzall, Esq. (as Personal Representative of the Estate of Thomas J. Guilfoil), Earl W. Wims, Michael Shanahan, Jr., Gary C. Gerhardt, Steven J. Landmann, David D. Mattern, and Gerald A. Potthoff.

Plaintiff's Statement of Facts is essentially a restatement of his Second Amended Petition ("Petition"). Most of his citations to the Legal File are citations to his Petition. In doing so, he treats his conclusory assertions and legal arguments as "facts," such as stating as a "fact" that Defendants violated their fiduciary duties. (Plaintiff's Opening Substitute Brief ("Pl. Br.") at 9).

The gravamen of Plaintiff's claim is that Defendants granted backdated stock options to certain ESSI Defendants. (Pl. Br. 5). As Plaintiff acknowledges in a quotation from the now-vacated Court of Appeals opinion, stock options are a common form of compensation, including backdated options (Pl. Br. at 6, quoting Appellate Opinion at 3, n.3, A041).

Plaintiff has made inconsistent allegations regarding how the merger of ESSI into DRS impacted his argument that he was damaged by the backdated options.

A. The First Lawsuit: Plaintiff Alleges DRS Paid Too Much to ESSI Shareholders (Plaintiff's Federal Derivative Suit).

Plaintiff's description of the "Initial Proceedings" in his Statement of Facts omits the first step in this litigation's history. The litigation began when Plaintiff Daniel

Nickell brought a derivative suit against DRS and some of the ESSI Defendants in federal court in the Eastern District of Missouri in August 2007 ("the Federal Derivative Suit") (Supplemental Legal File ("SLF") 395-432). The first four defendants in the Federal Derivative Suit are the first four defendants in the Petition and are alleged to have received backdated options: Michael F. Shanahan, Sr., Michael F. Shanahan, Jr., Steven J. Landmann, and Gary C. Gerhardt. Mark S. Newman of DRS is also named in both suits. The remaining defendants in the Federal Derivative Suit were members of DRS's board of directors who were named because they approved the merger and had not sought recovery from the ESSI Defendants. (Complaint in Federal Derivative Suit, ¶¶ 74, 91, 98, SLF 415, 418-20). The factual allegations in both suits are substantially similar, asserting wrongdoing by Defendants in connection with backdating of options, but with some important differences.

The Federal Derivative Suit alleged only harm to DRS, and not to any individual stockholder. Specifically, Plaintiff alleged that the alleged options backdating damaged or "caused significant damage" to DRS. (Complaint in Federal Derivative Suit, ¶¶ 5, 6, 133, 151, 156; SLF 396-97, 426, 428-29). Also, Plaintiff alleged that the "defendants were unjustly enriched at the expense of and to the detriment of DRS." (Complaint in Federal Derivative Suit, ¶ 132; SLF 426). In contrast, the instant lawsuit filed in state court alleges that the ESSI Defendants were unjustly enriched at the expense of someone else—the Plaintiff and his putative class of ESSI shareholders. (2nd Am. Pet. ¶ 118, LF 151).[2]

Plaintiff Nickell further asserted in the Federal Derivative Suit that the alleged backdating created expenses that "became an obligation of DRS." (Complaint in Federal Derivative Suit, ¶ 10, SLF 398). Nickell alleged that the DRS directors acted wrongfully because they had taken no action "to pursue recovery from the ESSI Defendants of the amounts by which DRS has been damaged." (Complaint in Federal Derivative Suit, ¶ 91, SLF 418).

The Federal Derivative Suit also differs from the Second Amended Petition in how it described the impact of the options backdating on DRS. Plaintiff alleged in the Federal Derivative Suit that DRS paid too much for ESSI stock. For instance, Plaintiff alleges that DRS "fully compensated the ESSI Defendants for their ESSI shares which it acquired in the merger and did not require the ESSI Defendants to pay back any of the money they had misappropriated through the option backdating activity." (Complaint in Federal Derivative Suit, ¶ 75, SLF 416). Plaintiff also alleged that another potential buyer of ESSI revised its offer downward as a result of the options backdating, and suggested that DRS should have done the same. (Complaint in Federal Derivative Suit,

[2] The phrase "putative" class is used in this Brief because no class has been certified in this case. Plaintiff did not file a motion for class certification as to the three counts at issue in this appeal.

¶¶ 80-81, SLF 416-17). The Federal Derivative Suit ended with a Stipulation of Dismissal with Prejudice filed on March 30, 2009. (SLF 481).

B. This Lawsuit: Plaintiff Alleges DRS Paid Too Little to ESSI Shareholders as a Whole.

On November 5, 2008, while the Federal Derivative Suit was pending, Plaintiff filed the instant action in state court. (LF 29). Plaintiff asserted the exact opposite of what he claimed in the Federal Derivative Suit, that is, he claimed in this lawsuit that DRS paid too little for ESSI. Plaintiff claimed that the ESSI Defendants "agreed to accept the lower sale price for ESSI" and the stockholders "received less for their ESSI common stock in the Merger than they would have but for defendants' wrongful conduct." (2nd Am. Pet. ¶¶74, 114, 118, 119, LF 142, 151-52).

In Count I, Plaintiff Nickell alleged his claim for Breach of Fiduciary Duty against all ESSI Defendants. (LF 148). Count II is a claim for Aiding and Abetting Breach of Fiduciary Duty against Defendant Newman only. (LF 150). Count III is a claim for Unjust Enrichment against Defendants Shanahan, Sr., Shanahan, Jr., Landmann, and Gerhardt only. (LF 151). Count IV is a claim for Negligent Misrepresentation against all Defendants that Plaintiff voluntarily dismissed and which is not before the Court in this appeal. (LF 152). Accordingly, the only counts that relate to the conduct of the ESSI Defendants are Counts I and III.

The Petition is premised on alleged backdating of stock options granted to certain of the ESSI Defendants and Defendants' alleged knowledge of that backdating. (2nd Am.

Pet. ¶¶ 37-90, LF 125-46). Plaintiff alleges that options were backdated between 1996 and 2003 (2^{nd} Am. Pet. ¶¶ 37, 40, LF 125, 127), which is three to ten years before DRS's acquisition of ESSI. (2^{nd} Am. Pet. ¶ 1, LF 113). He further alleges the backdated options were a form of secret compensation, injuring the value of ESSI by causing "ESSI to understate its compensation expense (and correspondingly overstate earnings)." (2^{nd} Am. Pet. ¶ 37(b), LF 126).

Plaintiff alleged that in April and May 2005, ESSI formally began looking for potential buyers. (2^{nd} Am. Pet. ¶ 53, LF 134). In July 2005, a third party made an initial offer to buy ESSI for \$40-\$42 per share, and after due diligence review, revised its offer downward in August 2005 to \$39-\$40 per share. (2^{nd} Am. Pet. ¶¶ 79-81, LF 143).

In September 2005, ESSI accepted an offer from DRS that was higher than the offer that the "third party" made before the alleged discovery of backdated options. The DRS offer was for \$43 per share, payable in a combination of cash and DRS stock. (2^{nd} Am. Pet. ¶ 56, LF 135). The total consideration to ESSI shareholders was approximately \$1.97 billion. (2^{nd} Am. Pet. ¶ 56, LF 136). At the time of the acquisition, there were 41,960,035 outstanding shares of ESSI (2^{nd} Am. Pet. ¶ 93, LF 147), meaning that DRS's offer represented an increase of anywhere from \$41,960,035 to \$167,840,140 over the third party's prior offer.

Nonetheless, Plaintiff claimed in the Petition that the value of ESSI was negatively impacted by the alleged undisclosed backdating of stock options from many years before.

C. The Relief Sought For All ESSI Shareholders.

Plaintiff does not allege that he was damaged in a way different from other shareholders. In fact, he purports to assert a putative class action suit on behalf of **all** former ESSI shareholders who sold their ESSI shares in connection with DRS's acquisition of ESSI. Plaintiff alleges that his claims "are typical of the claims of the other members of the Class[.]" (2nd Am. Pet. ¶¶ 1, 95, LF 113, 147).[3]

D. The Circuit Court Dismissed Plaintiff's Direct Claims, Holding that They May Only be Asserted as Derivative Claims.

In her June 27, 2011 Order, the Honorable Judge Joan L. Moriarty, Circuit Judge in the 22nd Judicial District, dismissed Counts I, II, and III. (LF 172-73). She held that "[Nickell] fail[ed] to allege any facts that relate to or claims that arise from a statutory right or special obligation that gives [Nickell] a right to sue Defendants individually." (LF 168-169). She allowed the Negligent Misrepresentation claim to stand (Count IV), but Plaintiff voluntarily dismissed that claim on October 15, 2012. On January 7, 2013, the Circuit Court entered its Final Judgment. (SLF 1).

[3] The only shareholders whom Plaintiff does not seek to represent in his class are those he sued. (2nd Am. Pet. ¶ 91, LF 146).

STANDARD OF REVIEW FOR ALL POINTS

Upon transfer, a case is decided by this Court "the same as an original appeal." Mo. Const., Art. V, § 10, *quoted in Murphy v. Carron,* 536 S.W.2d 30 (Mo. banc 1976). This Court reviews *de novo* a trial court's grant of a motion to dismiss for failure to state a claim upon which relief may be granted. *Lynch v. Lynch,* 260 S.W.3d 834, 836 (Mo. banc 2008). The trial court's judgment will be affirmed if it is correct on any ground supported by the record, regardless of whether the trial court relied on that ground. *Lough by Lough v. Rolla Women's Clinic, Inc.*, 866 S.W.2d 851, 852 (Mo. banc 1993). The Supreme Court "is primarily concerned with the correctness of the result, not the route taken by the trial court to reach it[.]" *Missouri Soybean Ass'n v. Missouri Clean Water Comm'n,* 102 S.W.3d 10, 22 (Mo. banc 2003).

ARGUMENT[4]

I. THE CIRCUIT COURT PROPERLY DISMISSED AS DERIVATIVE COUNTS I AND III BECAUSE THE TEST IS WHETHER PLAINTIFF SUFFERED INDIVIDUAL INJURIES DIFFERENT FROM THE SHAREHOLDERS AS A WHOLE, WHICH ADMITTEDLY DID NOT OCCUR.

In Point I, Plaintiff argues that he can bring the claims in his Petition as direct claims by ignoring the law which requires an injury distinct from the other shareholders and claiming the diminished stock price is not a corporate injury. Plaintiff is wrong on both points. Relying on *Centerre Bank of Kansas City, N.A. v. Angle*, 976 S.W.2d 608, 613 (Mo. App. 1998), the trial court properly dismissed Plaintiff's Petition for failure to state a claim. Plaintiff, asserting that he is a former shareholder of a former corporation, seeks to advance claims that can only be advanced in a derivative action on behalf of a corporation, not by a single shareholder. "It is well-established in corporate law that shareholders must normally bring a derivative action." *Id. at* 613. In Missouri, the fiduciary relationship of a corporate director or officer is between the directors and the shareholders **as a whole**, not any individual shareholder. *Dawson v. Dawson,* 645 S.W.2d 120, 125 (Mo. App. 1982). When an injury is to the shareholders collectively, the suit must be brought as a derivative action on behalf of the corporation. *Id.*

---

[4] Each Roman Numeral Section in this Brief corresponds to the same-numbered section in the Argument Portion of Plaintiff's Brief.

A. Shareholder Suits are Typically Derivative.

The parties agree that the general rule is that shareholder claims must usually be brought as derivative actions: "It is well-established in corporate law that shareholders must normally bring a derivative action in order to file a cause of action against an officer or director." *Centerre Bank*, 976 S.W.2d at 613. "Stockholders are not entitled . . . to recover for themselves for losses occasioned by the wrongful conduct of the directors in the management of the corporate affairs[.]" *Schick v. Riemer*, 263 S.W.2d 51, 55 (Mo. App. 1953). "Likewise, an action based on acts relating to a corporation's capital stock as a whole is a corporate cause of action that can only be sued for derivatively." *K-O Enters. v. O'Brien*, 166 S.W.3d 122, 129 (Mo. App. 2005). *See also Delahoussaye v. Newhard*, 785 S.W.2d 609, 612 (Mo. App. 1990).

Plaintiff's Petition purported to claim damages allegedly sustained by **all** shareholders. Indeed, Plaintiff insists that his claims and the claims of all shareholders are so identical that they should be tried as a class action. Plaintiff has never alleged that any defendant **directly** damaged **him**, and his brief before this Court puts forth no theory of damage distinguishable from any damage allegedly incurred by the other shareholders. The trial court's judgment dismissing Plaintiff's claims should be affirmed.

Plaintiff argues that this case involves one of the few circumstances in which an individual claim can be brought. But contrary to Plaintiff's assertion, the limited exceptions discussed in cases like *Centerre Bank* are not remotely like facts alleged in Plaintiff's Petition.

B. Missouri Cases Establish that a Claim Must be Brought Derivatively When the Harm is the Same to All Shareholders.

The crux of Plaintiff's argument in Point I is that an individual claim can be brought if there is a direct injury to shareholders that is distinct and independent of an injury to the corporation. Plaintiff argues that he alleges such direct and independent injuries in his Petition.

Plaintiff's argument must be rejected for two independent reasons. First, Missouri law has long and consistently explained what is meant by direct injuries versus corporate injuries.[5] If the injury is to shareholders "as a whole," their claim is not an independent injury giving rise to a direct (non-derivative) action. **There are no published Missouri cases allowing a direct action where, as here, a plaintiff alleges that shareholders as a whole incurred an injury.**

Second, under any definition of corporate injury, the injury here is a corporate injury, just as Plaintiff alleged in the Federal Derivative Suit. Plaintiff has asserted claims that would be applicable to all shareholders collectively, and not to him individually. Within his Substitute Brief, Plaintiff refers to "**Nickell and the Class**" more than 40 times. (Pl. Br. at 14-15, 17-18, 22-23, 25-27, 29-31, 35-36, 38-41) (emphasis added). His Second Amended Petition—the one that was dismissed after years of Plaintiff's attempts to state a viable cause of action—was bereft of any allegations of fact relating to Plaintiff specifically. (LF 111-155). Rather, in Count I, Plaintiff lumped himself together with all shareholders: "The ESSI Defendants owed and owe **Plaintiff**

[5] The parties agree that Missouri law controls. See Pl. Br. 19, n.9.

and the Class fiduciary obligations. By reason of their fiduciary relationships, the ESSI Defendants owed and owe **Plaintiff and the Class** the highest obligation of good faith, fair dealing, loyalty, and due care in connection with the sale of ESSI." (2nd Am. Pet. ¶ 101, LF 148) (emphasis added). Then specifically as to any allegation of harm, Count I concludes: "As a result of Defendants' wrongdoing, **Plaintiff and the Class** have been damaged." (2nd Am. Pet. ¶ 107, LF 150) (emphasis added).

Count III similarly alleged "unjust enrichment at the expense of and to the detriment of **Plaintiff and the Class,**" (2nd Am. Pet ¶ 118, LF 151) (emphasis added) and further alleged: "**Plaintiff and the Class** have been damaged." (2nd Am. Pet. ¶ 119, LF 151) (emphasis added).

Missouri cases consistently explain that an injury is not an independent injury giving rise to a direct shareholder action when the petition alleges that shareholders were injured collectively. Plaintiff all but concedes this point near the end of Point I: "To be certain, some Missouri decisions appear to distinguish between an injury 'to the shareholders individually' and one 'to the corporation - to the shareholders collectively' in determining whether the action can be brought individually." (Pl. Br. 32).

Plaintiff's concession as to what Missouri cases say is appropriate. For instance, *Centerre Bank* stated: "Although the fiduciary relationship of a director or officer of a corporation to the shareholders is well-recognized, that relationship is generally held to be between the directors and the shareholders **as a whole**." 976 S.W.2d at 613 (emphasis in original). In *Schick v. Riemer,* the Court held that plaintiff shareholders could not state a direct claim when "the injury is to the corporation (i.e. to the shareholders collectively) and not to the stockholders individually." 263 S.W.2d at 54. Other cases make the same point, holding that shareholders cannot sue directly where the "injury is to the corporation – to the shareholders collectively – and not to the shareholders individually." *Dawson v. Dawson*, 645 S.W.2d 120, 125 (Mo. App. 1982). *See also Place v. P.M. Place Stores Co.*, 950 S.W.2d 862, 865 (Mo. App. 1996) (holding where "injury is to the corporation, i.e. to the shareholders collectively, and not to the shareholders individually," the suit must be brought derivatively).

Federal courts applying Missouri law have consistently said the same thing: when injuries complained of "are the same as those sustained by any other shareholder . . . any action seeking relief must be brought derivatively." *Clockwork Home Servs. v. Robinson*, 423 F. Supp.2d 984, 992 (E.D. Mo. 2006). *See also Gray v. Bicknell*, 86 F.3d 1472, 1487 (8th Cir. 1996) (applying Missouri law and holding "the key element of being able to sue a corporation directly is individual injury separate and apart from any injury the stockholder qua stockholder sustains."). Plaintiff does not allege any special harm to him or to any shareholder other than the shareholders as a whole. In fact, he brought this case as a class action, that is, he seeks to bring a suit for the shareholders collectively and argues Defendants "acted on grounds generally applicable to the Class." (2nd Am. Pet. ¶¶ 1, 3, 91, 94-95, 99, LF 113-14, 146-48). Therefore, if the precedent on Missouri law is followed, Plaintiff loses.

Notwithstanding all of the above-cited case law, Plaintiff boldly asserts "[t]he argument that a stockholder cannot maintain a direct action if a similar injury was also suffered by other shareholders finds no support in Missouri law." (Pl. Br. 32). Unable to completely ignore the above-cited case law, Plaintiff asserts that "a review of these decisions shows that the courts there merely used the phrase 'shareholders collectively' as a synonym for the 'corporation.'" (Pl. Br. 32). Not surprisingly, Plaintiff provides no citation and there is absolutely no language from the above-cited cases supporting Plaintiff's desired interpretation. Multiple cases have specifically held there must be an injury distinct from other shareholders, and Plaintiff has not suffered such an injury. And in fact, in making the argument that **Missouri** cases mean something different from what they say, he cites only to **non**-Missouri cases. (Pl. Br. 33-34).

The conduct alleged here can give rise only to a derivative claim.[6]

---

[6] Plaintiff argues in a footnote that the ESSI Defendants did not suffer the same injury as other ESSI shareholders. (Pl. Br. 18, n.7). But that position is contrary to the allegations in his Petition. The alleged injury described in the Petition is a lower stock value that necessarily impacts all stockholders in a *pro rata* fashion. Plaintiff simply alleged in the Petition that the ESSI Defendants should be excluded from the putative class, presumably because he sued them, and Plaintiff's counsel could not purport to represent people they are suing. (2nd Am. Pet. ¶ 91, LF 146). An alleged diminished stock price would in fact harm even the defendants in the same fashion as Plaintiff. *See Grogan v. O'Neil*, 307 F. Supp.2d 1181, 1188-89 (D. Kan. 2004) (holding that claim was derivative and stating: "Although plaintiff has not included the Management Buyout Group in the proposed class, members of that group suffered the same alleged injury as all TransFinancial shareholders, *i.e.*, a reduced price for their shares.")

C. Allegedly Improper Backdated Stock Options Creates a Corporate Injury Under Any Standard, as Plaintiff Previously Alleged.

1. Alleging Overcompensation Through Stock Option Backdating is a Derivative Claim.

The Petition describes a corporate injury whether or not Missouri's "shareholders as a whole" requirement is considered. Plaintiff complains of stock option backdating. As Plaintiff and the Court of Appeals opinion here recognized, option backdating is a form of compensation. (Pl. Br. at 6, *quoting SEC v. Shanahan*, 646 F.3d 536, 540 (8th Cir. 2011) and *New England Carpenters Pension Fund v. Haffner*, 391 S.W.3d 453, 463-64 (Mo. App. 2012) (Lynch, J., dissenting)). As the Eighth Circuit explained: "Backdating options is not itself illegal under the securities laws, nor is it improper under accounting principles." 646 F.3d at 540.[7]

The instant Petition also states that the alleged misconduct of the ESSI Defendants "**exposed ESSI** to millions of dollars in civil liability . . . and **exposed the Company** [ESSI] and its successor [DRS] to costly investigations and lawsuits." (2nd Am. Pet. ¶ 28, LF 122) (emphasis added). Thus, the Petition describes corporate injuries to ESSI and its successor.

---

[7] *SEC v. Shanahan* was the civil suit by the SEC against Defendant Shanahan, Jr., for the type of conduct alleged in Plaintiff's Petition. The Eighth Circuit affirmed the district court's grant of judgment as a matter of law for Shanahan, Jr., based on the lack of evidence of false statements, lack of materiality, and other factors.

Plaintiff alleges that the stock options were improper, alleging that Defendants Shanahan, Sr. and Gerhardt received $9.6 million in "illicit proceeds." (2nd Am. Pet. ¶ 37, LF 126). In other words, Plaintiff complains that some Defendants were overcompensated over a time period that was three to ten years before the Merger, and that other Defendants facilitated paying some persons too much.

But an overcompensation claim is a classic example of a claim that can only be brought in a derivative action. Missouri courts have stated clearly that stockholders "cannot sue for the recovery of their proportionate share of money alleged to have been wrongfully abstracted by the officers in salaries from the corporation's treasury." *Schick*, 263 S.W.2d at 55 (holding plaintiff lacked standing to assert claims for excessive compensation). *Centerre Bank* held that claims for alleged diversion of assets to officers had to be brought as a derivative action, even where all shareholders joined in the action. 976 S.W.2d at 614. Indeed, the backdated options case Plaintiff cited in his Statement of Facts was brought as a derivative suit. *New England Carpenters Pension Fund*, 391 S.W.3d at 456, cited at Pl. Br. 6.

Plaintiff has tried to dress up this classic derivative claim by describing the backdating in the context of the merger with DRS. Implicitly, Plaintiff is seeking a rule of law that a derivative claim can be brought as an individual claim after a merger occurs simply by alleging that directors and officers did not disclose the existence of the potential derivative claim. Plaintiff cites no cases (and can cite no cases) supporting such a rule.

Under Missouri law, derivative claims do not become individual claims because a merger occurred.

2. Plaintiff Brought a Derivative Claim for the Complained-Of Stock Option Backdating.

Even assuming *arguendo* improprieties occurred, there are remedies without a direct action. Those who bought the stock of the company acquire any claims against officers and directors. If the acquiring company's officers and directors do not sue the prior officers and directors, they can be subject to a derivative suit to obtain those funds from the wrongdoers, if there is a legitimate claim.

That's what happened here. Plaintiff understood that the holder of any claim for any improper backdating was DRS, the company that bought ESSI. Plaintiff began this litigation with the Federal Derivative Suit directed to four ESSI Defendants (the first four named in this case) and DRS personnel for approving the merger and/or not suing certain ESSI Defendants to recover for the alleged wrongdoing. (Complaint in Federal Derivative Suit, ¶¶ 74, 91, 98, SLF 415, 418-20). In the Federal Derivative Suit, the **only** person or entity that Plaintiff said was damaged by the backdating was DRS. (Complaint in Federal Derivative Suit, ¶¶ 5, 6, 10, 132, 133, 151, 156; SLF 396, 397, 398, 426, 428, 429).

Thus, Plaintiff originally alleged that DRS was damaged because it paid too much for ESSI stock. According to Plaintiff, the alleged stock backdating reduced the true value of ESSI below the amount that DRS had paid. Plaintiff now alleges the opposite, claiming that DRS was not damaged because DRS paid more than ESSI's actual value.

Plaintiff claims that because he now alleges that DRS paid too little, the claim is direct, not derivative. But Plaintiff got it right the first time, at least on the issue of whether the claim is derivative.[8]

3. Plaintiff Already Received the Benefit of Restitution Awarded to DRS—the Derivative Entity.

Plaintiff alleges in his Petition that restitution has already been awarded in the amount of $9.6 million **to DRS**. (2nd Am. Pet. ¶¶ 5, 85, LF 115, 144). Plaintiff alleges he was a DRS stockholder. (2nd Am. Pet. ¶ 10, LF 117). That means Plaintiff (and the class Plaintiff seeks to represent) already received the benefit of being a shareholder of the company to which $9.6 million was awarded. Plaintiff is now trying to double dip and recover more after restitution was awarded. However, a core reason for the derivative-suit requirement is to avoid duplicative recovery for the same alleged harm, or

[8] Indeed, Plaintiff's claims should be subject to judicial estoppel, which "exists to prevent parties from playing fast and loose with the court." *In re Contest of Primary Election Candidacy of Fletcher*, 337 S.W.3d 137, 143 (Mo. App. 2011). After bringing a derivative suit on behalf of DRS, which was ultimately the recipient of restitution described below, he is now taking a clearly inconsistent position in hopes of recovering for a second time. This is precisely the type of behavior that judicial estoppel was meant to prevent. *See Fletcher*, 337 S.W.3d at 142 (estopping candidate for office from claiming Missouri residency because he filed pleadings in another court alleging he was domiciled in California).

later-claiming shareholders being unable to obtain their share of a recovery. *Centerre Bank,* 976 S.W.2d at 613. Further, this rule protects the corporation's creditors by ensuring that any recovery is subject to the creditors' rights, by directing the recovery to the corporation. *Clockwork Home Servs. Inc.*, 423 F. Supp.2d at 992 ("[E]ven if all shareholders injured by the corporate theft join in one suit, the suit must still be on behalf of the corporation.").

If the Circuit Court's judgment is reversed, Plaintiff would be proceeding with a claim seeking a benefit duplicating what he claims he, and other shareholders, already obtained and that Plaintiff has already alleged he should have been able to obtain in a derivative action.

As Plaintiff originally alleged, any harm from the backdated options was a corporate injury incurred by ESSI and passed on to DRS. Thus, Plaintiff's claim could only be brought as a derivative action.[9]

[9] The proceedings referenced in Plaintiff's Petition were, according to the Petition, related to charges of making false statements and falsifying corporate records, not the backdating of stock options. (2nd Am. Pet. ¶ 1, n.1, LF 113). In any event, taking the allegations as Plaintiff has pled them, $9.6 million was awarded by the federal court to DRS as "restitution." (2nd Am. Pet. ¶¶ 5, 85, LF 115, 144). Federal law requires restitution to be awarded to **all** identifiable victims, to the extent practicable, in consultation with the U.S. Attorney. 18 U.S.C. § 3664(d). The federal court "shall order restitution to each victim in the **full amount** of each victim's losses . . . ." 18 U.S.C.

D. The Petition Does Not Fall Into the Limited Circumstance Where Shareholder Plaintiffs Are Allowed to Bring Direct Claims Under Missouri Law.

In recognition that Missouri law requires claims like Plaintiff's to be brought derivatively, Plaintiff argues that his claims fit within the limited exception Missouri courts have recognized for direct shareholder lawsuits. But that exception involves a situation where the shareholder asserts the violation of a statutory right or special obligation that is unique or individual to the shareholder. *Centerre Bank*, 976 S.W.2d at 614. The cases Plaintiff cites only confirm that no such exception is applicable here.

1. The Few Missouri Cases Allowing Direct Claims Involved Truly Distinct Duties and Effects on a Small Group of Shareholders.

Plaintiff cites a few cases for the proposition that direct actions can be brought when the shareholder has an injury distinct from that of the corporation (Pl. Br. 17-31). But those cases actually involved clearly identifiable individual harm distinct from other shareholders. None involved a claim that a merger converted a corporate harm to an individual one.

---

§ 3664(f)(1)(A). If the number of victims is so large as to make restitution impracticable, the court is to make a finding to that effect. 18 U.S.C. § 3663A(c)(3). Thus, Plaintiff's own allegations show that the federal court and the U.S. Attorney found DRS to be the one and only "victim," excluding Plaintiff and his putative class.

Plaintiff principally relies on *Gieselmann v. Stegeman*, 443 S.W.2d 127 (Mo. banc 1969). (Pl. Br. 17-21). But *Gieselmann* is nothing like this case. The *Gieselmann* complaining shareholders alleged: (1) that their **individual requests for inspection of corporate records—a right given by statute <u>to</u> shareholders—had been refused**, (2) that their **individual stock certificates representing 14,840 shares were cancelled**, and (3) that a subsequent transfer of shares to third parties without consideration **displaced the plaintiffs from their status as majority shareholders**. *Gieselmann*, 443 S.W.2d at 130.

These claims are nothing like the shareholder-class claims here. In the case of the inspection of records, Missouri statutes create the inspection right as well as a remedy. Mo. Rev. Stat. § 351.215. The harms alleged in *Gieselmann* – unlike those alleged by Plaintiff Nickell – were unique to a discrete and limited group of identified shareholder plaintiffs. ESSI's other shareholders did not suffer any of the injuries the *Gieselmann* plaintiffs allegedly suffered. And in *Gieselmann*, the harm never was, and never could have been, inflicted on the corporation. *See Centerre Bank*, 976 S.W.2d at 614 (distinguishing *Gieselmann* on this basis).

To be sure, the facts of *Gieselmann* are significantly different from the facts presented by the Petition. Plaintiff alleged he was a shareholder of a publicly traded corporation, similarly situated to all other ESSI shareholders, claiming violations of fiduciary duties owed to "ESSI and its shareholders." Unlike the plaintiff in *Gieselmann*, Plaintiff did not hold shares in a closely held corporation with only a handful of shareholders. 443 S.W.2d at 132-135. Unlike the plaintiff in *Gieselmann*, Plaintiff did not have his shares of stock taken away from him by a "long-time friend, adviser and attorney" and then, without his knowledge, transferred to an officer/director of the corporation. *Id.* at 131, 136. Unlike the plaintiff in *Gieselmann*, Plaintiff was not the victim of a gross abuse of corporate formalities in direct contravention of a court order. *Id.* at 136.

The court specifically explained what took *Gieselmann* out of the general rule that "[o]rdinarily an action based on acts relating to the capital stock as an entirety is a corporate cause of action and cannot be sued for by a shareholder merely as an individual." 443 S.W.2d at 131. The determining factor was that the act complained of "work[ed] an injury to rights belonging to the stockholders individually **as between them and the corporation and its other stockholders . . .** where an unlawful increase of stock oust[ed] the complaining stockholders from their position as controlling shareholders." 443 S.W.2d at 131-32 (emphasis added). The Petition here does not and cannot allege the type of extraordinary circumstances that took *Gieselmann* out of the general rule.

Plaintiff also relies on the Missouri Court of Appeals decision in *Place v. P.M. Place Stores Co.*, 950 S.W.2d 862, 865 (Mo. App. 1996). (Pl. Br. 21). But in *Place*, the plaintiff shareholders challenged a transfer of stock that displaced them as "controlling shareholders." Plaintiff here is not making an argument that he was displaced as a controlling shareholder. The court in *Place* recognized the rule that "[g]enerally, corporate shareholders cannot in their own right and for their own personal benefit maintain an action for the recovery of corporate funds or property improperly diverted or appropriated by the corporation's officers and directors." 950 S.W.2d at 865. That is the type of injury that ESSI would have incurred from using stock options as compensation, if the use was improper. That is why Plaintiff initially sought recovery for the successor corporation (DRS).

Relying on *Gieselmann*, the court in *Place* held that, "where an unlawful increase of stock ousts the complaining stockholders from their position as controlling stockholders, the injury to the complaining stockholder **is distinct from that suffered by other stockholders**, and the action must be maintained individually." *Id.* at 865. (emphasis added). In fact, Plaintiff, in his Substitute Brief, specifically noted the most critical point of the court's holding setting forth language which flies in the face of his position: "The court of appeals concluded that the shareholders sufficiently alleged a direct injury to them **distinct from that suffered by other shareholders**." (Pl. Br. 21) (emphasis added).

Plaintiff's third case drives home this same point. *Dawson v. Dawson*, 645 S.W.2d 120 (Mo. App. 1982). (Pl. Br. 21). In *Dawson*, the plaintiff alleged he was **denied access to books and records**, and he challenged **excessive fees** paid to the chairman and the **transfer of stock from the plaintiff's father to the company's chairman**. 645 S.W.2d at 123-24. The *Dawson* Court correctly held that the denial of a shareholder's **statutory** right to books and records can be asserted as a direct claim. But *Dawson* also held that **the stock transfer claim could not be brought as an individual claim**, pointing out that the fiduciary duty of officers and directors is to "shareholders *as a whole.*" 645 S.W.2d at 125 (emphasis in original). The court rejected the notion that corporate officers owed duties directly to shareholders, which is contrary to Plaintiff's assertions. *Id*.

Finally, Plaintiff cites *Massie v. Barth*, 634 S.W.2d 208, 211 (Mo. App. 1982), for the proposition that an individual action can be brought where there is a special obligation or relationship. (Pl. Br. 22). *Massie* merely held that when the officer/director is also a trustee, the beneficiary can sue for breach of a fiduciary duty as a trustee. *Massie* stands for the unremarkable proposition that officer/director status does not bar a claim that would otherwise exist for breach of an independent duty like that of a trustee. 634 S.W.2d at 211. *See Centerre Bank,* 976 S.W.2d at 614 (distinguishing *Massie* on this basis).

2. There is No Cause of Action for Injury to the "Right to Vote Shares in an Informed Manner".

Plaintiff next tries to shoehorn his claim into the above cases by asserting that the "individual harm" is injury to the putative class's "right to vote their shares in an informed manner" because of failure to disclose information related to the backdated options. (Pl. Br. 22-31).

First, a claim regarding the right to vote in an informed manner applies equally to all shareholders and therefore it would be a derivative claim, if a viable claim at all.

Second, the Petition does not include a claim for interfering with the "right to vote in an informed manner." The dismissal of the Petition cannot be reversed based on a non-pleaded claim. Nor did Plaintiff make that argument before the Circuit Court, so it cannot be the basis for reversal by this Court: "[T]his Court will not, on review, convict a lower court of error on an issue which was not put before it to decide." *Lozano v. BNSF Railway Co.*, 2014 WL 438582, at *11, n.6 (Mo. banc 2/4/14, mandate issued 3/25/14). *Accord*, *Smith v. Shaw*, 159 S.W.3d 830, 835 (Mo. banc 2005); *Lincoln Credit Co. v. Peach*, 636 S.W.2d 31, 36 (Mo. banc. 1982). Nor was this new theory to support a claim of error by the trial court included in Plaintiff's brief before the Missouri Court of Appeals. Mo. S. Ct. R. 83.08(b) (a substitute brief "shall not alter the basis of any claim that was raised in the court of appeals brief").

Third, the lack of such a claim in the Petition is not surprising. Plaintiff cites no cases from any court in any jurisdiction holding that interference with a "right to vote shares in an informed manner" is a cognizable legal harm or injury. Although there can be claims for deceptive statements in connection with securities sales, no courts have called those claims "a right to vote in an informed manner." True fraud cases invoke the speaker's duty, not the listener's "right." Plaintiff describes his claim as a "right" to try to make his claim look individual, when it is not.

Fourth, if Plaintiff is trying to describe a misrepresentation claim in an unusual and awkward fashion as a "right to vote in an informed manner," he still has not described a breach of fiduciary duty claim. Plaintiff brought a misrepresentation claim (Count IV). But he voluntarily dismissed it, purportedly so that he could appeal what would otherwise be an interlocutory order dismissing Counts I, II, and III. (Pl. Br. 12). Perhaps he has seller's remorse in dismissing his misrepresentation claim that the trial court allowed him to pursue. But that is no reason to state that he has a cause of action under the breach of fiduciary counts.

Neither of the authorities Plaintiff cites supports his position. *See Gieselmann* and 12B WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 5915. (Pl. Br. 23-25). Fletcher lists 11 examples of individual actions, and the "right to vote in an informed manner" is **not** one of them. Plaintiff refers to the part of Fletcher mentioning a right to vote **at a shareholder's meeting.** (Pl. Br. 24). It makes sense that a shareholder has a direct claim if she is told she cannot vote. That is nothing like a claim complaining about information disseminated before a vote. The other reference is for a deceptive or misleading proxy statement. (Pl. Br. 24). But Plaintiff dismissed his misrepresentation claim.[10]

In fact, the treatise Plaintiff cites supports Defendants' position that this is a derivative claim. If the cause of action "is based on acts relating to the capital stock as an entirety, or a particular class of stock, it is ordinarily a corporate cause of action and cannot be the basis for an action by a shareholder merely as an individual." Fletcher, § 5915. The authority that Fletcher cites is none other than this Court's decision in

---

[10] Plaintiff points out in a footnote that the trial court found that Plaintiff stated a cause of action for fraud. (Pl. Br. 26, n.11). That fact works against Plaintiff. The trial court distinguished between the breach of fiduciary duty claims (dismissed) and the now-dismissed claim for "fraud" ("negligent misrepresentation") in the Petition. It was Plaintiff who chose not to pursue a misrepresentation claim by dismissing that Count voluntarily. The part of the trial court's ruling not before this Court cannot be used to bootstrap Plaintiff's other counts.

Gieselmann. As stated above, it is undisputed that Plaintiff's Petition is based on acts relating to the capital stock in its entirety.

3. Failure to Disclose the Backdating is Not Subject to an Individual Action as a "Direct Fraud".

Another tack that Plaintiff takes is to claim that the failure to disclose the backdating arrangement and "secret agreements" in connection with the prospectus constitutes a "direct fraud" upon shareholders, which Plaintiff contends entitles him to bring a direct action. (Pl. Br. 25-30).

That argument also fails. As explained above, Plaintiff is taking a classic derivative claim (improper compensation via backdating), and trying to convert it to a direct claim. Plaintiff can cite no cases allowing a claim that was derivative to be brought as an individual after a merger or buy-out.

a. *Gieselmann* Does Not Support Plaintiff's Position Because the Extraordinary Circumstances in *Gieselmann* Are Not Alleged to Be Present Here.

Plaintiff cites two cases in support of his argument that the backdating falls within some sort of "direct fraud" exception. The first is *Gieselmann.* But as explained above, the type of "direct fraud" referenced in *Gieselmann* was nothing like the allegations of misleading information in a prospectus. While the Court in *Gieselmann* ultimately found that a direct claim existed, it was not the fraudulent transfer of stock itself that created the direct action. It was the fact that the fraudulent transfer ousted certain plaintiffs from their status as majority shareholders, thereby **causing an injury unique to them** and not shared by the other shareholders generally.

b. *Grogan* and Its Progeny Show that Plaintiff's Claim is Derivative.

The only other case Plaintiff cites on this point is *Grogan v. Garner*, 806 F.2d 829 (8th Cir. 1986) (Pl. Br. 27-30). The injury alleged by the plaintiffs in *Grogan*–unlike the injury alleged by Plaintiff–was unique to the *Grogan* plaintiff shareholders, and not suffered by all of the shareholders generally. *Grogan* supports Defendants here because it noted that the result would be different under facts like those here: a challenge to the overall consideration paid in a sale.

The plaintiffs in *Grogan* were two of nine shareholders of STI-Missouri who alleged that they did not receive their share of the proceeds of a sale of the company. On November 17, 1978, **after** the shareholders approved a sale of the company, the defendant officer transferred stock in a related company to the benefit of other shareholders and to the detriment of plaintiffs. *Grogan*, 806 F.2d at 832-33, n.5. Plaintiffs did not get their share of the assets transferred after they approved the sale, despite being told otherwise. 806 F.2d at 833.

In allowing the plaintiff shareholders to pursue direct claims, the Eighth Circuit noted that the result would be different under other facts, specifically, if the plaintiff shareholders **were challenging the overall consideration paid as part of the acquisition.** 806 F.2d at 835. The Eighth Circuit expressly held that such a claim (like Plaintiff's here) would attack something affecting **all** shareholders and would likely amount to a derivative action, as required by *Dawson*, 645 S.W.2d at 124-26. *Grogan*, 806 F.2d at 835, n.7. Thus, *Grogan* supports Defendants' position.

Later Eighth Circuit decisions distinguishing and interpreting *Grogan* further illustrate that Plaintiff's claim is precisely the type of claim that must be brought derivatively. In *Gray*, the Eighth Circuit revisited its decision in *Grogan* and confirmed the distinction between direct and derivative claims under Missouri law. *Gray*, 86 F.3d at 1487-89.

Like Plaintiff's claims, *Gray* involved a challenge to a transaction that affected the overall value of stock. The shareholder plaintiff alleged that the defendant mismanaged the company, caused it to file bankruptcy, and thereby caused the plaintiff to lose the true value of his shares. *Id.* at 1487-88. Citing *Gieselmann* and *Grogan*, the Eighth Circuit held that in evaluating whether a claim is direct or derivative under Missouri law, the "key element of being able to sue a corporation directly is **individual injury separate and apart from any injury the stockholder qua stockholder sustains**." *Id*. at 1487 (emphasis added). Consistent with the Missouri decisions that both parties cite, the Eighth Circuit held that the fact that the bankruptcy caused plaintiff's shares to lose value is a loss that would be suffered equally by every other shareholder, and thus, was not an individual action. *Id*. at 1488.

The Eighth Circuit reached a similar conclusion in *Arent v. Distribution Sciences, Inc*., 975 F.2d 1370 (8th Cir. 1992). While *Arent* relied on Minnesota law, the Eighth Circuit cited and interpreted its decision in *Grogan*. The *Arent* plaintiffs asserted a direct claim and alleged that the defendant misrepresented the prospects of a merger, causing the plaintiffs to buy or hold stock in the company, and then suffer a loss after the truth came out. *Id*. at 1372. Citing *Grogan*, the Eighth Circuit held that the plaintiffs did not have standing, because a claim of fraud only results in a direct claim when "the fraud causes separate and distinct injury" to the plaintiff. *Id*. at 1373. The Eighth Circuit explained that its holding in *Grogan* was motivated by the fact that only **some** of the shareholders were injured where the fraud was directed to those particular plaintiffs. *Id*. Unlike *Grogan*, where only some of the shareholders suffered an injury, the alleged misrepresentations in *Arent* affected all the shareholders equally, and thus, the court held the claim must be brought derivatively. *Id.*

Grogan and its progeny establish that a claim based on the overall consideration paid for stock (like Plaintiff's claim) is a derivative claim.

4. There was Not a "Special Fiduciary Duty" to Maximize the Value in the DRS Merger.

Plaintiff also argues that Defendants had a special fiduciary duty to maximize shareholder value in a merger, citing only non-Missouri cases, and primarily relying on *Shenker v. Laureate Educ., Inc.,* 983 A.2d 408, 411 Md. 317 (2009). (Pl. Br. 30-31). But here is no reference to a "special" fiduciary duty in his Petition or in his Court of Appeals brief, so this argument should be disregarded. Mo. S. Ct. R. 83.08(b). Also, these arguments are absent from Plaintiff's long and detailed memorandum in opposition to the Defendants' motions to dismiss in the trial court. (LF at 490-533). Indeed, the terms "special fiduciary duties" and "controlling shareholder" never appear in the Second Amended Petition. (LF at 110- 155). As stated above, this Court should not find error on a Point Relied On neither pleaded nor argued to the Circuit Court. *Lozano*, 2014 WL 438582, at *11, n.6; *Smith v. Shaw*, 159 S.W.3d at 835; *Lincoln Credit*, 636 S.W.2d at 36.

Moreover, *Shenker* is completely different as *Shenker* involved a cash-out merger. Here, the shareholders received DRS stock as part of their consideration (2nd Am. Pet. ¶ 3, LF 114). That is a crucial distinction because upon receipt of shares of the merging company, Plaintiff had an interest in that company's recovery for any wrongful acts such as the allegedly improper backdating. That is precisely why Plaintiff was able to begin this litigation with a derivative action based on his capacity as a DRS shareholder in the Federal Derivative Suit. Plaintiff and the other shareholders also received the benefit of the restitution awarded to DRS.

At least one federal court has refused to apply *Shenker* to a merger that involved a combination of stock and cash as a payment option: "I have reservations as to the applicability of *Shenker* in the first instance. The duties of candor and maximization of value that directors directly owe to shareholders recognized in *Shenker* arise in a very narrow context—specifically, that of a cash-out merger when the decision to sell the corporation already has been made." *Stender v. Cardwell*, 2010 WL 1930260, at *4 (D. Colo. May 12, 2010).

Even in the jurisdictions where such a rule exists, the question remains whether that claim is derivative or direct. A Kansas federal court addressed the issue head-on and held that even though a claim for not obtaining the highest value for the stock could exist, such a claim is derivative if the putative class is comprised of all non-management shareholders. *Grogan v. O'Neil,* 307 F. Supp.2d 1181, 1188-89 (D. Kan. 2004). The court was following the rule described above that exists in Missouri: when all shareholders are affected in the same or a *pro rata* way, the claim is derivative.

E. Delaware Law Does Not Apply.

Plaintiff argues that he has a claim that might be cognizable under Delaware law. He is mistaken in this assertion, which at any rate does not matter to a claim under Missouri law.

Delaware law does not apply to this case. Plaintiff brought this action "for violations of Missouri law." (2nd Am. Pet ¶ 1, LF 113). The Defendants were alleged to have "violated Missouri law." (2nd Am. Pet ¶¶ 2, 6, 28, 104, LF 114, 116, 122, 149). Plaintiff alleged that ESSI was a Missouri corporation with its principal place of business in St. Louis. (2nd Am. Pet ¶ 11, LF 117). Plaintiff's Petition does not mention Delaware. (LF 111-155). In his brief before this Court, Plaintiff concedes that "Missouri substantive law determines whether his claims are direct or derivative." (Pl. Br. 19, n.9).

To any extent that Delaware law would lead to a result contrary to the judgment of the circuit court in this case, it should be rejected. This Court is bound to follow the most recent controlling decision of the Supreme Court of Missouri. *Weil v. Director of Revenue*, 304 S.W.3d 768, 770 (Mo. App. 2010); *Missouri Highway & Transp. Comm'n v. Merritt,* 204 S.W.3d 278, 283 (Mo. App. 2006). This Court should reject any Delaware precedent to any extent that it is inconsistent with precedent from the Supreme Court of Missouri. *See Gieselmann v. Stegeman,* 443 S.W.2d 127 (Mo. 1969); *Caldwell v. Eubanks,* 30 S.W.2d 976, 980 (Mo. 1930). Other states have done just this, refusing to apply cases cited by Plaintiff as contrary to the decisions of their highest courts. *See*

Estate of Browne v. Thompson, 727 S.E.2d 573, 576 (N.C. App. 2012); *Lewis v. CNL Restaurant Properties, Inc.*, 223 S.W.3d 784, 787 (Tex. App. 2007).

F. Delaware Case Law Decided After the Cases on Which Plaintiff Relies Shows that Plaintiff's Claim is Derivative.

Even the Delaware cases on which Plaintiff relies do not help him, and the most recent Delaware pronouncements are squarely against him.

Plaintiff argues that Delaware and other non-Missouri cases have a different test that allows for individual claims even when all shareholders are treated the same. (Pl. Br. 31-35). Specifically, Plaintiff argues that a 2004 Delaware case rejects the previous requirement that claims alleging harm falling on all shareholders equally must be brought derivatively. *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1035 (Del. 2004), cited at Pl. Br. 33.

But any ambiguity in *Tooley* was clarified by the Delaware Supreme Court four years later, when it specifically held that a claim that a shareholder received too little money in a merger based on pre-merger stock options can only be brought derivatively, even in a complete cash-out merger. *Feldman v. Cutaia*, 951 A.2d 727, 733 (Del. 2008). The Delaware Supreme Court affirmed the Chancery Court's granting of a motion to dismiss, which stated that the plaintiff-shareholder was "creatively attempting to recast a derivative claim by alleging the same fundamental harm in a slightly different way." 951 A.2d at 730. The court noted that when the claim is based on improper stock options, the claim is one for "corporate overpayment," which must be brought derivatively. 951 A.2d at 733.

Particularly noteworthy, the Delaware Supreme Court in *Feldman* also reaffirmed that Delaware (like Missouri) follows the "shareholders as a whole" test to determine whether a claim is derivative: "Where all of a corporation's stockholders are harmed and would recover *pro rata* in proportion with their ownership of the corporation's stock solely because they are stockholders, then the claim is derivative in nature." 951 A.2d at 733.

Feldman is indistinguishable from the facts of this case and Missouri law. If this case had been brought in Delaware and involved a Delaware corporation, *Feldman* would require the same result reached by the trial court here.[11]

Plaintiff also argues that his claim is direct because he is alleging conduct that caused the merger price to be lower, citing *Parnes v. Bally Entm't Corp.,* 722 A.2d 1243 (Del. 1999) (holding that the plaintiff's attack on merger was direct, not derivative). (Pl. Br. 31). Again, *Feldman* is directly on point and was decided after *Parnes.* Also, *Parnes* expressly recognized that an attack on a merger itself can only be brought as a derivative claim. 722 A.2d at 1245. Moreover, in *Parnes,* the plaintiff made allegations that are the opposite of what Plaintiff alleges here. The *Parnes* plaintiff alleged that the defendants'

[11] *Feldman* also affirms the principle that only current shareholders can bring derivative claims. 951 A.2d at 731. Plaintiff's Federal Derivative Suit alleged he was a shareholder of the successor corporation, DRS, (Complaint in Federal Derivative Suit, ¶ 16; SLF 399), which apparently is no longer the case.

wrongdoing (CEO demanding personal benefits from **all** potential acquirors) discouraged other potential acquirors. 722 A.2d at 1246.

Here, Plaintiff alleges that another suitor conducted due diligence and slightly revised its offer downward, allegedly because of "options granting practices and liabilities associated therewith." (2nd Am. Pet. ¶¶ 3, 79-81, LF 114, 143). Plaintiff here does not allege that this unnamed suitor—or any other—was impacted by any request for a success fee or other alleged benefits. Plaintiff's own Petition quotes the proxy statement showing that the $5 million success fee was fully disclosed. (2nd Am. Pet. ¶ 55, LF 135). And here, the ultimate acquirer (DRS) paid **more** than the **first,** allegedly untainted proposal from the unnamed suitor. (2nd Am. Pet. ¶¶ 79-81, LF 143). Unlike *Parnes*, there is no allegation here that the process was tainted by making demands of all suitors.

Moreover, "Delaware courts have interpreted the *Parnes* exception very narrowly." *In re NYMEX Shareholder Litig.*, 2009 WL 3206051, at *10 (Del. Ch. Sept. 30, 2009). Even the *Parnes* Court explained that when there is corporate waste, "a resulting drop in the value of the company's stock [] is a classic derivative claim . . . . The fact that such a claim is asserted in the context of a merger does not change its fundamental nature." 722 A.2d at 1245. Claims incidental to a merger but not arising from the merger (such as the allegations of options backdating here) remain derivative claims. *Kramer v. W. Pac. Indus., Inc.* 546 A.2d 348, 353-54 (Del. 1988); *see also In re Syncor Int'l Corp. Shareholders Litig.*, 857 A.2d 994, 997-98 (Del. Ch. 2004).

Because Plaintiff alleges that the backdating practices depressed the stock value, Plaintiff's claims must be derivative, even under *Parnes*.

Finally, Delaware has additional limitations even when it allows direct claims, including requiring that such claims be in an amount to be material to the transaction. This would be another reason why Plaintiff's claims would fail even under Delaware law. In Delaware, the trial court, in order to determine whether the plaintiff's claims are direct or derivative on a motion to dismiss, digs into the merits of the case and assesses whether the alleged conduct is material in relation to the price of the overall merger consideration. *In re NYMEX Shareholder Litig.*, CIV.A. 3621-VCN, 2009 WL 3206051, at *10 (Del. Ch. Sept. 30, 2009) (citing *Golaine v. Edwards*, CIV.A. 15404, 1999 WL 1271882, at *6 (Del. Ch. Dec. 21, 1999). Under this materiality requirement, one Delaware court held that a negotiation fee of $20 million was immaterial and denied the plaintiff standing to assert a direct claim. *Golaine*, 1999 WL 1271882, at *8 ("The $20 million seems quite immaterial in the scheme of things."). Another court held that a $95 million package including indemnification of the board of directors while "not a trifle . . . [was] also not material in the context of an $8.5 billion merger." *In re Massey Energy Co.*, CIV.A. 5430-VCS, 2011 WL 2176479, at *28 (Del. Ch. May 31, 2011). Thus, Plaintiff would have had his claim dismissed if brought in Delaware for lack of materiality.[12]

---

[12] The $5 million negotiation fee paid to Shanahan, Sr., in proportion to the total merger consideration ($1.97 billion), is nearly identical to the $20 million negotiation fee paid for the $8 billion merger in *Golaine*, and is dwarfed by the $95 million paid in *Massey*.

Plaintiff has not stated a direct claim under either Missouri or Delaware law.

G. Plaintiff's Allegation that Some Part of His Claim is Non-Derivative Does Not Justify Reversal of the Circuit Court's Dismissal Order.

Finally, Plaintiff argues that his claim can be both derivative and individual, so his Petition should not be dismissed. (Pl. Br. 34-35). But that begs the question of whether an individual claim is stated at all. In the two cases Plaintiff cites in support of his argument, there was an independent basis for a duty to the plaintiff who happened to be a shareholder as well. For instance, in *Massie*, the court relied on *Gieselmann* to note that plaintiffs could maintain individual suits against the defendant who was also a **trustee.** 634 S.W.2d at 211. Likewise, in *Grogan v. Garner*, the court stated that a person who based an individual action on a contract might also have a derivative action as a stockholder. 806 F.2d at 834. But here, Plaintiff's claim flows entirely from his status as a stockholder.

Moreover, *Gieselmann* makes clear that a sliver of an individual claim is not enough: the "gravamen of the pleading has" to establish injury to plaintiffs as individuals. 443 S.W.2d at 131.

II. THE DISMISSAL ORDER CANNOT BE REVERSED BASED ON THE ARGUMENT THAT DEFENDANTS ARE CONTROLLING SHAREHOLDERS BECAUSE THE PETITION SHOWS THEY ARE NOT CONTROLLING SHAREHOLDERS.

Plaintiff argues that the dismissal order must be reversed because the ESSI Defendants were allegedly controlling shareholders and therefore a special fiduciary relationship existed between them and Plaintiff and his putative class. (Pl. Br. 36-39). This argument must be rejected.

The Petition does not even contain a legal conclusion that the ESSI Defendants, individually or collectively, were controlling shareholders. Nor was this argument made before the Court of Appeals. Mo. S. Ct. R. 83.08(b). This alone justifies rejection of this argument. Again, this Court should not find error on a Point that was not pleaded or argued to the Circuit Court. *Lozano*, 2014 WL 438582, at *11, n.6; *Smith v. Shaw*, 159 S.W.3d at 835; *Lincoln Credit*, 636 S.W.2d at 36.

Moreover, the facts alleged in the Petition confirm that Defendants are not controlling shareholders. Plaintiff alleged that the most shares any ESSI Defendant owned was 3%. (2nd Am. Pet. ¶ 15, LF 119). The next highest percentage was 2.2%. (2nd Am. Pet. ¶ 17, LF 119). Plaintiff did not plead whether other Defendants owned outstanding ESSI stock or, if so, in what amounts. But based on Plaintiff's allegations that no one else has as much as 2.2%, all ESSI Defendants combined could not exceed 22%. The lowest "controlling shareholder" figure that Plaintiff could find in any case law was almost twice that amount: 42%. *Bayne v. Jenkins*, 593 S.W.2d 519, 524 (Mo.

banc 1980) (defendants owned 42% of company, and sale resulted in purchaser owning a majority of stock; action on promissory note with no count for breach of fiduciary duty). (Pl. Br. 38).

Plaintiff also argues that Defendants were controlling shareholders because they allegedly "effectively controlled the corporation's board of directors and its Compensation Committee" and were able to quickly negotiate a sale of ESSI (Pl. Br. 37-39). But these arguments are *non sequiturs*. Control of the Board is not a factor to consider in determining whether persons or groups are "controlling shareholders." If that were the case, all stockholder/directors would be controlling shareholders because, by definition, they would control the corporation. No court has ever adopted that kind of rule in any published opinion.

That is why the cases Plaintiff cites all base the assessment of whether a shareholder was a "controlling shareholder" on ownership or control of a majority of the shares of stock, not "control" of the company. *See, e.g., Whale Art Co. v. Docter,* 743 S.W.2d 511, 514 (Mo. App. 1987) (49% shareholder controlled 51% of shares with 2% owned by father); *Fix v. Fix Material Co.,* 538 S.W.2d 351, 356, 358 (Mo. App. 1976) (48% shareholder controlled "a majority of the outstanding stock" when acting in concert with other shareholders); *Peterson v. Continental Boiler Works, Inc.,* 783 S.W.2d 896, 904 (Mo. 1990) (referring to a fiduciary duty by "majority shareholders" to minority shareholders, with no reference to "controlling shareholders" or any criterion other than majority shareholder status); *Dubroff v. Wren Holdings, LLC*, 2011 WL 5137175, at *3

(Del. Ch. Oct. 28, 2011) (control group controlled 56% of shares). It is not surprising that determining controlling shareholder status is based on control of shares.

Moreover, Plaintiff's reliance on *Whale Art* is misplaced. (Pl. Br. 38). In *Whale Art*, the defendant shareholder acted in concert with a second shareholder, and collectively, they controlled over 51% of the company's shares. 743 S.W.2d at 514. And contrary to the foundation of Plaintiff's argument, the court in *Whale Art* declared that "controlling shareholders are not fiduciaries in the strict sense." 743 S.W.2d at 514. Instead, "the general concepts of fiduciary law are useful in measuring conduct by those in control" entitling the minority to dissolve a corporation under the terms of the dissolution statute. 743 S.W.2d at 514. This distinction between "control" for purposes of the Missouri dissolution statute, and the concept of a "controlling shareholder" for purposes of ordinary fiduciary duty claims, is important. If personal and business ties among board members were all that was required to make those individuals "controlling shareholders," and (as Plaintiff suggests) subject to special duties, shareholders could convert any derivative claim into a direct claim by merely naming all the corporation's board members as defendants. Missouri law does not–and should not–allow such an absurd result.

Moreover, Missouri courts have repeatedly dismissed direct claims against "controlling shareholders" because the plaintiffs lacked standing to bring those claims individually. In *Centerre Bank*, the plaintiffs alleged that the defendant owed them fiduciary duties "in his capacity as the majority shareholder" in their company. *Centerre*

Bank of Kansas City, N.A. v. Angle, 976 S.W.2d 608, 612 (Mo. App. 1998). Relying on *Gieselmann* and other Missouri cases, the court rejected plaintiffs' arguments that their claims were direct, holding that the plaintiffs' relationship with the defendant "is not the type of 'special relationship' which prior Missouri cases have held may provide standing for individual actions." *Id*. at 614. Beyond being a director, there was no other additional trust and confidence imposed by virtue of an ancillary relationship such as trustee, advisor or attorney.

Similarly, in *K-O Enters.*, the court squarely rejected the notion that a minority shareholder has standing to assert direct claims against "controlling shareholders" that are otherwise derivative in nature. *K-O Enters. v. O'Brien*, 166 S.W.3d 122, 129-30 (Mo. App. 2005) (holding minority shareholder's breach of fiduciary duty claims against 75% controlling shareholder were derivative and, therefore, minority shareholder had no claim). And in *Schick*, the court held that the plaintiff had no standing to sue directly on a claim that "a single, dominant, majority and controlling stockholder" had paid himself money out of the corporate treasury "without the knowledge and approval of, ratification by, or discussion with substantial minority stockholders." 263 S.W.2d at 52, 55; *see also Dawson*, 645 S.W.2d at 124-26 (plaintiff had no standing to bring direct claims against a 97% controlling shareholder other than those based on denial of the right to inspect corporate books and records); *Bruner v. Workman Oil Co.*, 78 S.W.3d 801, 804 (Mo. App. 2002) (plaintiff lacked standing to bring direct claims against "majority shareholders").

Missouri courts have repeatedly rejected direct claims when the only alleged basis is the allegation that the defendants were collectively "controlling shareholders." The "controlling shareholder" argument is wrong factually and legally and does not provide a basis for reversal.

III. THE CIRCUIT COURT PROPERLY DISMISSED THE PETITION FOR FAILURE TO ALLEGE THE NECESSARY ELEMENT OF A FIDUCIARY DUTY TO THE SHAREHOLDERS.

Plaintiff's final point is a repetitive and circular argument. Because, according to Plaintiff, he has the right to bring a direct action (see Point I) and there is a special relationship (see Point II), he has alleged a fiduciary duty. He concludes by arguing that because Plaintiff was injured by Defendants' conduct, a fiduciary duty existed. (Pl. Br. 40-42). The reasons why Plaintiff's Points I and II should be rejected are discussed above.

Plaintiff asserts that the ESSI Defendants owed fiduciary duties to the shareholders individually "under the specific circumstances of this case." (Pl. Br. 41-42). He cites case law identifying three sources from which legal duties may arise and relies on the second such source, a catch-all in which "a particular set of circumstances" requires someone to exercise due care to avoid foreseeable injury. *Robert T. McLean Irrevocable Trust v. Patrick Davis, P.C.*, 283 S.W.3d 786, 793 (Mo. App. 2009).

But even under *Robert T. McLean,* there has to be a basis for a fiduciary duty before the complained-of conduct occurs. Plaintiff is trying to bootstrap the conduct up to become the basis for the duty. *Robert T. McLean* merely mentioned that "a particular set of circumstances" can be one of three potential sources of a "legal duty." 283 S.W.3d at 793. The case does not otherwise mention or rely on a "particular set of circumstances" for creation of a fiduciary duty.

Simply stated, to have a claim for breach of fiduciary duty, there has to be a fiduciary duty. Plaintiff acknowledges, as he must, that a duty by directors and officers to individual shareholders is the exception. The Circuit Court properly dismissed the Petition on this alternative basis.

CONCLUSION

The issue before this Court is **not** whether there is a civil claim that could be brought against Defendants. The issue is limited to whether the trial court correctly concluded that the breach of fiduciary duty and unjust enrichment claims can only be brought derivatively. Plaintiff has brought a putative class action, claiming he and all other shareholders were harmed proportionally to their ownership. He alleges that ESSI and its successor DRS were harmed by Defendants' conduct. He identifies the harm as improper stock options, *i.e.*, overcompensation. He told the United States District Court that his claim was derivative. Restitution was already awarded to DRS.

For these reasons and all of the reasons stated herein, the judgment dismissing the Petition should be affirmed in all respects.

Dated April 1, 2014

Respectfully Submitted,

GREENSFELDER, HEMKER & GALE, P.C.

/s/ Erwin O. Switzer

Richard E. Greenberg, #37916
Wendy S. Menghini, #51381
Erwin O. Switzer, #29653
Michael A. T. Schwalbert, #63229
Greensfelder, Hemker & Gale, P.C.
10 S. Broadway, Suite 2000
St. Louis, Missouri 63102
Telephone: (314) 241-9090
Facsimile: (314) 345-8624
Email: REG@greensfelder.com
Email: WMS@greensfelder.com
Email: EOS@greensfelder.com
Email: MS@greensfelder.com

Attorneys for Defendant/Respondent Earl W. Wims

GUILFOIL PETZALL & SHOEMAKE, L.L.C.

/s/ Eric M. Walter

Jim J. Shoemake, #19695
Eric M. Walter, #47297
E. Calvin Matthews IV, #58278
Guilfoil Petzall & Shoemake, L.L.C.
100 South Fourth Street, Suite 500
St. Louis, Missouri 63105
Telephone: (314) 241-6890
Facsimile: (314) 241-2389
Email: JJS@gpslegal.com
Email: EMW@gpslegal.com
Email: ECM@gpslegal.com

Attorneys for Defendants/Respondents Kenneth E. Lewi, Crosbie E. Saint, and Gerhard Petzall, Esq. as Personal Representative of the Estate of Thomas J. Guilfoil

DOWD BENNETT LLP

/s/ James G. Martin
James G. Martin, #33586
7733 Forsyth Blvd., Suite 1900
St. Louis, Missouri 63105
Telephone: (314) 889-7300
Facsimile: (314) 863-2111
Email: jmartin@dowdbennett.com

Attorneys for Defendant/Respondent Michael F. Shanahan, Jr.

DOWD BENNETT LLP

/s/ Edward L. Dowd, Jr.
Edward L. Dowd, Jr., #28785
James F. Bennett, #46826
John D. Comerford, #60164
7733 Forsyth Blvd., Suite 1900
St. Louis, Missouri 63105
Telephone: (314) 889-7300
Facsimile: (314) 863-2111
Email: edowd@dowdbennet.com
Email: jbennett@dowdbennett.com
Email: jcomerford@dowdbennett.com

Attorneys for Defendant/Respondent Gary C. Gerhardt

SCHULTZ & ASSOCIATES LLP

/s/ Robert Schultz

Robert Schultz #35329
Ronald J. Eisenberg, #48674
640 Cepi Drive, Suite A
Chesterfield, Missouri 63005
Telephone: (636) 537-4645
Facsimile: (636) 537-2599
Email: rschultz@sl-lawyers.com
Email: reisenberg@sl-lawyers.com

Attorneys for Defendant/Respondent Steven J. Landmann

LEWIS, RICE & FINGERSH, L.C.

/s/ Barry A. Short

Barry A. Short, #19028
Evan Z. Reid, #51123
Steven D. Hall, #56762
600 Washington Ave., Ste. 2500
St. Louis, Missouri 63101
(314) 444-7600 (Telephone)
(314) 241-6056 (Facsimile)
Email: bshort@lewisrice.com
Email: ereid@lewisrice.com
Email: shall@lewisrice.com

Attorneys for Defendant/Respondent David D. Mattern

WITTNER, SPEWAK & MAYLACK, P.C.

/s/ David von Gontard
David von Gontard, #48030
231 S. Bemiston, Suite 2010
Clayton, MO 63105
(314) 862-3535 Telephone
(314) 862-5741 Facsimile
Email: DvonGontard@wsmspc.com

Attorneys for Defendant/Respondent
Gerald A. Potthoff

CERTIFICATE OF SERVICE AND COMPLIANCE

I hereby certify that on the 1st day of April, 2014, I electronically filed a true and accurate copy of the foregoing Brief with the Clerk of the Court using the Missouri Supreme Court's electronic filing system, which sent notification of such filing to the counsel of record.

In accordance with Missouri Supreme Court Rule 84.06(b) and (c), the undersigned certifies that the foregoing Brief (1) includes the information required by Rule 55.03, (2) complies with the type-volume limitations, using thirteen point double-spaced typeface, (3) and the number of words in this brief is 12,559 words, excluding the cover page, certificate of service, this certificate of compliance, and the signature block, based on the word count of the Microsoft Word program. The undersigned further certifies that the electronic copies of this brief filed with the Court were scanned for viruses and found virus-free.

/s/ Erwin O. Switzer
Erwin O. Switzer, #29653
Attorney for Defendant/Respondent
Earl W. Wims

1471181