SC93719

IN THE

Supreme Court of Missouri

DANIEL B. NICKELL,

Plaintiff-Appellant,

vs.

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

Defendants-Respondents.

Transferred from the Missouri Court of Appeals, Eastern District, Division One
Hon. Clifford H. Ahrens, Hon. Sherri B. Sullivan, and Hon. Glenn A. Norton
Court of Appeals Case No. ED99163

On Appeal from the Circuit Court of St. Louis City, Missouri, Division 31
Hon. Joan L. Moriarty
Circuit Court Case No. 0822-CC09449-01

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Dated: February 24, 2014

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JURISDICTIONAL STATEMENT

Plaintiff-Appellant Daniel B. Nickell brought this action in the Circuit Court of St. Louis City under Rule 52.08 of the Missouri Rules of Civil Procedure on behalf of himself and all other similarly-situated shareholders of Engineered Support Systems, Inc. ("ESSI"), a Missouri corporation, seeking to recover damages resulting from the 2006 merger between ESSI and DRS Technologies, Inc. (the "Merger"). LF 148 (¶ 91).[1] On June 27, 2011, the Circuit Court entered an order granting:

- Defendant Mark S. Newman's Motion to Dismiss for Lack of Subject Matter Jurisdiction Due to SLUSA Preclusion, or, in the Alternative, for Failure to State a Claim as to Nickell's failure to state a claim; and
- the motions to dismiss filed by Defendants Michael Shanahan, Sr., Michael Shanahan, Jr., David Mattern, Thomas Guilfoil, Kenneth Lewi, Crosbie Saint, Earl Wims, Gary Gerhardt, Gerald Pothoff, and Steven Landmann for failure to state a claim regarding counts I, II, and III of Nickell's Second Amended Petition.

LF 156-173. On January 7, 2013, following voluntary dismissal of Nickell's remaining claims, the Circuit Court entered final judgment. SLF 1. Under Rules 81.04(a) and 81.05(b), Nickell timely filed his Notice of Appeal on October 23, 2012. LF 345.

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[1] "LF," "SLF," and "R-SLF" refer to Appellant's Legal File (volumes 1 and 2), Appellant's Supplemental Legal File (volumes 1 and 2), and Respondents' Supplemental Legal File (volumes 1 and 2), respectively.

The Court of Appeals, Eastern District had jurisdiction over this appeal under MO. ANN. STAT. § 512.020 because Nickell seeks review and reversal of the January 7, 2013 final judgment of the Circuit Court disposing of all claims arising under Missouri law. SLF 1; *see also Avidan v. Transit Cas. Co.*, 20 S.W.3d 521, 523 (Mo. 2000).

The Court of Appeals heard argument on May 14, 2013. In a unanimous opinion dated June 4, 2013, the Court of Appeals reversed the Circuit Court.

Defendants-Respondents filed multiple motions for rehearing and applications for transfer to this Court. On September 24, 2013, the Court of Appeals denied those motions and applications. Defendants then filed applications for transfer with this Court.

On February 4, 2014, this Court sustained the applications for transfer and ordered the cause transferred. The Court has jurisdiction pursuant to Missouri Constitution, Article V, Section 10 and Rule 83.04 of the Missouri Rules of Civil Procedure.

STATEMENT OF FACTS

I. The Parties

Nickell was a stockholder of ESSI at all relevant times. LF 117 (¶ 10). Between July 2, 2002 and December 31, 2005, Nickell regularly acquired ESSI stock and received dividends that ESSI distributed based on that stock ownership. SLF 745-48. Over nearly four years, Nickell contributed a total of $8,779.01 toward the purchase of ESSI shares and, at the time of ESSI's merger with DRS, he owned 437.5879 shares of ESSI common stock. SLF 748. Nickell sold his ESSI common stock in connection with the Merger and received DRS common stock and cash in exchange. LF 117 (¶ 10).

At all relevant times, Defendants Michael Shanahan, Sr., Michael Shanahan, Jr., David Mattern, Gary Gerhardt, Gerald Pothoff, and Steven Landmann were directors and officers of ESSI, and Defendants Thomas Guilfoil, Kenneth Lewi, Crosbie Saint, and Earl Wims were directors of ESSI.[2] LF 118-120 (¶¶ 13-23). Defendant Mark Newman was the CEO and Chairman of DRS. LF 120 (¶ 24). Defendant PricewaterhouseCoopers LLP ("PwC") is a registered limited liability partnership and public accountant. LF 121 (¶ 25). During the Class Period,[3] PwC served as the auditor for ESSI and audited each of ESSI's annual publicly-reported financial statements. *Id.*

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[2] Collectively, Shanahan, Sr., Shanahan, Jr., Mattern, Gerhardt, Pothoff, Landmann, Guilfoil, Lewi, Saint, and Wims are referred to as the "ESSI Defendants."

[3] The Class Period encompasses the time between September 22, 2005 and the effective date of the Merger on or about January 31, 2006, inclusive. LF 146 (¶ 91).

II. Initial Proceedings

Nickell brought this class action on behalf of all former holders of ESSI stock who sold their shares pursuant to a false and misleading Registration Statement disseminated in connection with the acquisition of ESSI by DRS (the "Class"). LF 113 (¶ 1). Excluded from the Class are Defendants and any of their affiliates. LF 146 (¶ 91).

After filing an original petition, Nickell was granted leave to file an amended petition, adding PwC as a defendant. R-SLF 433-434. The amended petition alleged five causes of action under Missouri law: (1) breach of fiduciary duty on the part of the ESSI Defendants; (2) an accounting by the ESSI Defendants; (3) aiding and abetting breach of fiduciary duty by Newman and PwC; (4) unjust enrichment against all Defendants; and (5) negligent misrepresentation against all Defendants. LF 42.

PwC removed the action to the United States District Court for the Eastern District of Missouri (the "District Court") on the basis of federal question jurisdiction, arguing that Nickell's action was precluded by the Securities Litigation Uniform Standards Act ("SLUSA"). R-SLF 481. The District Court found "that the Delaware Carve–Out exception to the SLUSA applies, that this action may properly be maintained in state court, [and] that removal was improper," and remanded the action. R-SLF 488.

On remand, the ESSI Defendants and PwC moved to dismiss Nickell's claims in the amended petition, arguing, among other things, that SLUSA precluded the action and that the first amended petition failed to state a claim upon which relief could be granted because Nickell lacked standing to bring individual claims against them. LF 42-43. The Circuit Court (Judge Robert H. Dierker) declined to revisit the ruling of the District Court

on the issue of SLUSA preclusion. LF 43-44. The Circuit Court also found that Nickell had standing to bring his claims individually and, on that basis, declined to dismiss Nickell's count I for breach of fiduciary duty. LF 45-47. The Circuit Court concluded that Nickell had adequately alleged "that his individual rights were violated by Defendants' conduct" and that Nickell and other shareholders "suffered personal financial loss" due to the breaches of duty by Defendants. LF 47.

Ultimately, the Circuit Court granted the motions in part, denied the motions in part, and granted Nickell leave to amend. Thereafter, Nickell filed his second amended petition, and the cause was reassigned to Judge Joan L. Moriarty of the Circuit Court.

III. Substantive Allegations in the Second Amended Petition

A. The Backdating of ESSI Stock Options

The Court of Appeals summarized Nickell's allegations with regard to the stock option backdating scheme at ESSI as follows:

> Between 1996 and 2003, the ESSI Defendants granted Shanahan Sr., Shanahan Jr., Gerhardt, and Landmann millions of dollars of backdated employee stock options in violation of ESSI's stock option plans. [LF 125-132 (¶¶ 37-47).] Despite public representations that the stock options were issued "at the money," the options were actually issued "in the money," enabling Shanahan Sr., Shanahan Jr., Gerhardt, and Landmann to improperly divert financial benefits to themselves. [LF 125-126 (¶ 37).]

Nickell v. Shanahan, No. ED 99163, slip op. at 3 (Mo. Ct. App. June 4, 2013).

In describing the backdating scheme at ESSI, and the difference between options granted "at the money" and "in the money," the Court of Appeals found the following passage helpful:

> "One common form of compensation is the stock option, which grants a recipient the right to purchase a specified number of shares of the company's stock at a specified price, referred to as the 'exercise' or 'strike' price. When the market price of a publicly traded stock is equal to an option's exercise price, the option is said to be 'at the money.' When the market price exceeds the exercise price, the option is 'in the money.' If an option is 'at the money' when granted, it will only enrich the recipient if the stock price rises in the future. But if the option is granted 'in the money' and can be exercised immediately, it is to that extent equivalent to a cash bonus if the recipient is an employee. The grant of 'in-the-money' options rewards favored employees without requiring cash outlays by the company. But it also affects investors because it dilutes the position of shareholders when the option is exercised."

New England Carpenters Pension Fund v. Haffner 391 S.W.3d 453, 463 (Mo. Ct. App. 2012) (Lynch, J., dissenting) (quoting *S.E.C. v. Shanahan*, 646 F.3d 536, 540 (8th Cir. 2011)). Thus, "'[b]ackdating' occurs when the grant date of a stock option precedes the date the decision is made to award the stock option. This often occurs when the stock price was lower on the grant date than the decision date, resulting in immediate 'in the money' compensation to the recipient." *Nickell*, slip op. at 3 n.3 (citations omitted).

The fact that backdating occurred at ESSI is undisputed. LF 125 (¶ 37) (the ESSI Defendants granted certain stock options "in the money," despite public representations that the options were issued "at the money"); *see also* LF 126-127 (¶ 39) (the backdating of the stock options violated the contractual provision of ESSI's stock options plans requiring that "[t]he option price of shares subject to any stock option shall be the closing price of the stock on the date that the stock option is granted").[4] In fact, in July 2008, Defendants Shanahan, Sr. and Gerhardt pleaded guilty to criminal conduct and agreed to pay restitution. LF 115, 144 (¶¶ 5, 85). Defendants' wrongdoing was later described by the United States Attorney for the Eastern District of Missouri as "one of the most egregious examples of backdating among all of the publicly traded companies in the United States." LF 115 (¶ 5). Neither the Registration Statement nor the Prospectus issued by Defendants to induce the Class to vote in favor of the Merger made any mention of the backdating of stock options at ESSI. LF 136-139 (¶¶ 57-65).

B. The Merger

By 2005, as other public companies became subject to increasing scrutiny over similar options-backdating schemes, Shanahan, Sr. instructed ESSI's directors to begin serious negotiations to sell ESSI to DRS. LF 133-134 (¶¶ 51-53). This move was notable because it represented a sharp break from Shanahan, Sr.'s long history of being adamantly opposed to any sale of ESSI. LF 133-134 (¶¶ 51-54). The Court of Appeals

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[4] *See also Shanahan*, 646 F.3d at 542 ("[T]he SEC presented ample evidence to submit to the jury the issue whether ESSI granted 'backdated' options.").

summarized Nickell's allegations regarding the Merger as follows:

> Beginning in 2005, the ESSI Defendants were motivated to sell ESSI quickly in order to avoid liability for their misconduct associated with the backdating of stock options. [LF 133-135, 142-143 (¶¶ 51-54, 77).] As a result, on September 21, 2005, ESSI and DRS entered into an agreement whereby DRS would acquire ESSI. [LF 135-136 (¶ 56).] Newman, aware of the ESSI Defendants' improper backdating scheme, agreed that DRS would assume any corresponding liability. [LF 123-124, 141-142 (¶¶ 31-33, 74).] The ESSI Defendants agreed to accept a reduced purchase price from DRS in exchange for DRS' assumption of liability relating to the backdating misconduct and other personal benefits including: (1) having the backdated stock options accelerated and cashed out; (2) a continuation of benefits for at least one year; and (3) an officers' liability insurance policy.[5] [LF 123-124, 135, 139-140 (¶¶ 31, 33, 55, 66-68).] In order to effectuate shareholder approval for the merger, Respondents disseminated false registration statements and prospectuses that concealed the backdating misconduct and the fact that the ESSI Defendants were to receive personal benefits from DRS in exchange for a reduced purchase price. [LF 124, 136-137 (¶¶ 34, 57-60).] The concealment of the ESSI Defendants'

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[5] Shanahan, Sr. also received an additional $5 million payoff as compensation for his "consulting services" in connection with the sale of ESSI. LF 135 (¶ 55).

conduct induced Nickell and the purported class to vote to approve the merger and sell their ESSI stock at a reduced price. [LF 113-114 (¶¶ 1-2).]

Nickell, slip op. at 3-4.

C. The False and Misleading Disclosures

On November 23, 2005, in violation of their fiduciary duties and to effectuate the Merger, Defendants disseminated a false and misleading Registration Statement (the "Registration Statement") to induce Nickell and other ESSI shareholders to approve the Merger. LF 124 (¶ 34). The joint proxy statement/prospectus was first mailed to ESSI shareholders on December 23, 2005. LF 136 (¶ 57).

The Registration Statement contained a letter from PwC to the Board of Directors and shareholders of ESSI. LF 137 (¶ 61). The PwC letter falsely certified that the financial statements included in the Registration Statement complied with generally accepted accounting principles ("GAAP"). *Id.* After urging ESSI's shareholders to rely upon PwC's letter and other false and misleading statements in the Registration Statement, the ESSI Defendants unanimously recommended that ESSI shareholders vote in favor of the Merger. LF 139 (¶ 65).

The Registration Statement concealed: (1) that DRS was assuming all liability for the ESSI Defendants' options backdating misconduct; and (2) that the ESSI Defendants had abdicated their obligation to act in the best interests of ESSI shareholders in exchange for the personal benefits from DRS and Newman, including DRS's complete assumption of liability for the ESSI Defendants' misconduct arising out of their options backdating. LF 136 (¶ 58). The Registration Statement was also false and misleading

because it failed to disclose the options backdating and related activity at ESSI in the "Risk Factors" section. LF 137 (¶ 60).

In May 2006, merely four months after the Merger closed, DRS was forced to take a $12.5 million charge to cover the anticipated costs associated with the options backdating that occurred at ESSI. LF 143 (¶ 82).

IV. Nickell's Claims in the Second Amended Petition

Based on the foregoing allegations, Nickell's second amended petition alleged four counts, which the Court of Appeals summarized as follows:

> In Count I, Nickell alleged that the ESSI Defendants breached their fiduciary duties of good faith, due care, loyalty, honesty, reasonable inquiry, oversight, and supervision by accepting improper personal benefits and failing to act in the best interests of ESSI shareholders to obtain the highest price possible in connection with the sale of ESSI. Specifically, Nickell alleges that, in exchange for personal benefits, the ESSI Defendants induced Nickell and the purported class, through the filing of false and misleading registration statements and prospectuses, to approve the merger and sell their stock at a reduced price. In Count II, Nickell alleges that Newman aided and abetted the ESSI Defendants' breaches of fiduciary duties by knowingly assisting the ESSI Defendants in DRS' acquisition of ESSI despite having knowledge of the improper backdating scheme and false statements filed by the ESSI Defendants. Under Count III, Nickell alleges a claim of unjust enrichment against Shanahan Sr., Shanahan Jr.,

Gerhardt, and Landmann, claiming that he and the purported class received less for their ESSI stock as a result of payments received by Shanahan Sr., Shanahan Jr., Gerhardt, and Landmann in exchange for their wrongful conduct. Count IV alleges a claim of negligent misrepresentation against all defendants as a result of the defendants' alleged recommendations to ESSI shareholders to approve ESSI's merger with DRS.

Nickell, slip op. at 4-5.

Shortly after Nickell filed his second amended petition, all of the Defendants moved to dismiss Nickell's claims on several grounds. LF 156-157. On June 27, 2011, Judge Moriarty granted the motions to dismiss for the most part, dismissing counts I, II, and III as to all Defendants and count IV as to Defendant Newman. LF 172-173. The dismissal contradicted Judge Dierker's September 3, 2010 order.

V. Dismissal of the Second Amended Petition

As previously noted, following the remand, the ESSI Defendants and PwC moved to dismiss Nickell's claims in the amended petition on the grounds of SLUSA preclusion and Nickell's lack of standing. LF 42-43. With respect to SLUSA preclusion, Judge Dierker declined to revisit the ruling of the District Court. LF 43-44. Judge Dierker also found that Nickell had standing to bring his claims individually (*i.e.*, as a direct action) and, on that basis, declined to dismiss count I for breach of fiduciary duty. LF 45-47.

During the second round of motions to dismiss, Defendants again challenged the Circuit Court's subject matter jurisdiction under SLUSA as well as Nickell's standing to bring a direct action for breach of fiduciary duty. LF 158. Judge Moriarty found that

Defendants failed to meet their burden of proving lack of subject matter jurisdiction. LF 159-161. Judge Moriarty, however, agreed with Defendants' argument as to standing and granted their motions to dismiss as to counts I and III, concluding:

> In Counts I and III Plaintiff fails to allege any facts that relate to or claims that arise from a statutory right or special obligation that gives Plaintiff a right to sue Defendants individually. Plaintiff has not alleged a cause of action to sue Defendants in his own right as to these claims. As such, Counts I and III must be dismissed for failure to state a claim.

LF 168-169. As an alternative basis for dismissing count I, Judge Moriarty found that Nickell failed to state a claim because he did not allege the necessary element of duty:

> A corporate officer or director owes a fiduciary duty only to the corporation and the shareholders as a whole. Corporate officers do not owe a fiduciary duty to individual shareholders.

LF 169. Because count II, for aiding and abetting a breach of fiduciary duties, was based on count I and count I was dismissed for failure to state a claim upon which relief can be granted, Judge Moriarty also dismissed count II. LF 169-170. Finally, Judge Moriarty declined to dismiss count IV as to all of Defendants (except Newman), concluding that it adequately "state[d] a claim for fraud" and, therefore, could be brought directly against the ESSI Defendants. LF 169-171. To facilitate an appeal of Judge Moriarty's dismissal, Nickell voluntarily dismissed his remaining claims on October 15, 2012. SLF 1.

On October 23, 2012, Nickell filed his Notice of Appeal. LF 345. The Circuit Court entered final judgment on January 7, 2013. SLF 1.

VI. The Court of Appeals' June 4, 2013 Opinion

After hearing argument on May 14, 2013, the Court of Appeals reversed and remanded in a unanimous opinion. The court granted Nickell's first point on appeal, concluding that "[b]ecause the second amended petition sets forth allegations asserting violations of rights individual to Nickell and the purported class that caused them direct injury, Nickell has standing to maintain his claims individually." *Nickell*, slip op. at 8.[6]

The Court of Appeals also granted Nickell's third point on appeal, concluding that because "the ESSI Defendants' breaches of fiduciary duties violated rights individual to Nickell and the purported class that injured them directly," the second amended petition adequately alleged that "the fiduciary duties owed by the ESSI Defendants extended to Nickell and the purported class individually." *Id.* at 9-10.

Finally, the Court of Appeals rejected two alternative grounds for affirmance advanced by Newman. *Id.* at 14. Because the "Delaware carve-out" applied, the Court of Appeals concluded that there was no SLUSA preclusion. *Id.* at 11-12. The Court of Appeals also held that "a claim for aiding and abetting a breach of fiduciary duties [was] a recognized cause of action" in Missouri and concluded that Nickell adequately alleged a cause of action for aiding and abetting against Newman. *Id.* at 13-14.

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[6] Because Nickell's second point on appeal asserted an alternative basis for finding that he has standing to assert his claims individually – the conclusion that the Court of Appeals already reached in granting Nickell's first point on appeal – the Court of Appeals did not address the second point on appeal. *Nickell*, slip op. at 9 n.7.

POINTS RELIED ON

POINT I: The Circuit Court erred in dismissing as derivative counts I, II, and III because a direct claim exists where it is alleged that the plaintiffs suffered an injury independent from the one suffered by the corporation, and because in this case Nickell and the Class did suffer an injury distinct from the one suffered by ESSI.

Gieselmann v. Stegeman, 443 S.W.2d 127 (Mo. 1969) (*per curiam*).

Centerre Bank of Kansas City, Nat'l Ass'n v. Angle, 976 S.W.2d 608 (Mo. Ct. App. 1998).

Massie v. Barth, 634 S.W.2d 208 (Mo. Ct. App. 1982).

Grogan v. Garner, 806 F.2d 829 (8th Cir. 1986) (applying Missouri law).

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POINT II: As an alternative ground for reversal, the Circuit Court erred in dismissing as derivative counts I, II, and III because a direct claim exists where it is alleged that the corporation's controlling shareholders breached their fiduciary duties, and in this case the petition adequately alleges that the ESSI Defendants qualify as controlling shareholders and that they did breach their fiduciary duties.

Bayne v. Jenkins, 593 S.W.2d 519 (Mo. banc 1980).

Gieselmann v. Stegeman, 443 S.W.2d 127 (Mo. 1969) (*per curiam*).

Whale Art Co. v. Docter, 743 S.W.2d 511 (Mo. Ct. App. 1987).

POINT III: The Circuit Court erred in dismissing count I for failure to allege the necessary element of duty because a fiduciary relationship extends to the shareholders individually if the directors and officers violated rights individual to the shareholders that injured the shareholders directly, and in this case the fiduciary relationship is present because Nickell and the Class suffered an injury distinct from the one suffered by ESSI.

Gieselmann v. Stegeman, 443 S.W.2d 127 (Mo. 1969) (*per curiam*).

Centerre Bank of Kansas City, Nat'l Ass'n v. Angle, 976 S.W.2d 608 (Mo. Ct. App. 1998).

Dawson v. Dawson, 45 S.W.2d 120 (Mo. Ct. App. 1982).

Robert T. McLean Irrevocable Trust v. Patrick Davis, P.C., 283 S.W.3d 786 (Mo. Ct. App. 2009).

STANDARD OF REVIEW

This Court reviews *de novo* a trial court's grant of a motion to dismiss for failure to state a claim. *Lynch v. Lynch*, 260 S.W.3d 834, 836 (Mo. banc 2008). In doing so, "the facts contained in the petition are treated as true and they are construed liberally in favor of the plaintiffs." *Id.*; *see also Whipple v. Allen*, 324 S.W.3d 447, 449 (Mo. Ct. App. 2010). "If the petition sets forth any set of facts that, if proven, would entitle the plaintiffs to relief, then the petition states a claim." *Lynch*, 260 S.W.3d at 836. In short, a "petition states a cause of action if 'its averments invoke principles of substantive law [that] may entitle the plaintiff to relief.'" *Id.* (citation omitted).

ARGUMENT

I. The Circuit Court Erred in Dismissing as Derivative Counts I, II, and III Because a Direct Claim Exists Where It Is Alleged that the Plaintiffs Suffered an Injury Independent from the One Suffered by the Corporation, and Because in this Case Nickell and the Class Did Suffer an Injury Distinct from the One Suffered by ESSI.

In Missouri, the test for determining whether an action can be maintained on an individual basis is well-settled. As this Court held in *Gieselmann v. Stegeman*, a shareholder can maintain a direct action where the injury suffered is distinct from any harm incurred by the corporation. 443 S.W.2d 127, 131 (Mo. 1969) (*per curiam*). Nothing has changed in the two scores and five years since *Gieselmann* was decided to warrant its reexamination. On the contrary, during the past forty-five years, the Missouri Courts of Appeals (including the Court of Appeals in this case) have faithfully applied this Court's precedent as set forth in *Gieselmann*.

A review of these opinions reveals a two-step analytical framework for determining whether the suit is properly brought as a direct action. *First*, the Court should look at who suffered the alleged harm. *Second*, the Court should ask who would receive the benefit of any recovery. "[I]ndividual actions are permitted, and provide the logical remedy" where "the injury is to the shareholders themselves directly" and "any recovery would belong to the shareholder." *Centerre Bank*, 976 S.W.2d at 614.

Tested under *Gieselmann* and *Centerre Bank*, Nickell properly brought this suit as a direct action because the harm suffered by Nickell and the Class is distinct from that

suffered by ESSI. As the Court of Appeals recognized, "[t]he crux of the second amended petition is that Respondents' concealment of misconduct in false and misleading registration statements and prospectuses induced Nickell and the purported class to approve DRS' acquisition of ESSI and sell their individual shares in connection with the acquisition." *Nickell*, slip op. at 8. The injury alleged – the right of Nickell and other shareholders to cast their shares in an informed manner and to receive a full and fair merger consideration – is the right individual to them, *not* the corporation. The fact that a similar injury was also suffered by many (but not all) other ESSI shareholders[7] or that the misconduct also injured ESSI does *not* defeat the individual nature of Nickell's injury.

By inducing Nickell and the Class to approve the Merger on the basis of false and misleading information, Defendants also committed a "direct fraud" upon them. Under established Missouri law, this gives rise to a direct action. The Circuit Court erred in holding to the contrary and in precluding Nickell's claims at the pleading stage.[8]

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[7] Notably, the injury was *not* suffered by the ESSI Defendants or their affiliates, even though they were also shareholders of ESSI. *See* LF 146 (¶ 91).

[8] Indeed, in upholding Nickell's count IV, the Circuit Court concluded that Nickell *did* "state[] a claim for fraud" against all Defendants except Newman. LF 169-171. Under this Court's decision in *Gieselmann*, Nickell's allegations of fraud adequately state a claim for relief as to the three claims that the Circuit Court dismissed. *See* 443 S.W.2d at 131 ("Stockholders may maintain an action on an individual basis . . . against directors, officers, or others for the redress of wrongs constituting a direct fraud upon them.").

A. Under Missouri Law, a Direct Action Can Be Maintained Where the Injury Suffered Is Distinct from the One Suffered by the Corporation

Under Missouri law,[9] "[a]ctions based upon torts where the injury is done directly to an individual shareholder . . . depriving him of his rights . . . are actions which may be brought by shareholders as individuals, and are not required to be brought as derivative actions." *Gieselmann*, 443 S.W.2d at 131. As such, a shareholder has standing to maintain an action *in his or her own right* where the shareholder asserts a violation of rights individual to them. *Centerre Bank*, 976 S.W.2d at 614. "[I]ndividual actions are permitted, and provide the logical remedy, if the injury is to the shareholders themselves directly, and not to the corporation." *Id.* "In such cases, any recovery would belong to the shareholder so the shareholder has the right to sue individually." *Id.*

1. The Court Must Look at the "Gravamen of the Pleading" to Determine Whether the Shareholder Suffered Some Injury that Is Distinct from the Injury Suffered by the Corporation

In determining if the injury is individual, the focus should be on "the gravamen of the pleading." *Gieselmann*, 443 S.W.2d at 131. In *Gieselmann*, several shareholders brought an individual suit against several other shareholders and the corporation. *Id.* at 130. The plaintiffs alleged that they had been fraudulently deprived of controlling stock

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[9] Nickell was a shareholder of ESSI, which was a Missouri corporation at all relevant times. Thus, Missouri substantive law determines whether his claims are direct or derivative. *See Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 108-09 (1991).

in the corporation and of positions on the board and as officers. *Id.* Specifically, plaintiffs alleged that defendants (1) cancelled plaintiffs' certificates of stock for 14,840 shares and issued the same number of shares to themselves; and (2) issued to themselves an additional certificate of stock for 8,000 shares. *Id.* at 131. Looking at the crux of the complaint, the Court concluded that the two alleged injuries were individual. *Id.*

First, the Court focused on defendants' fraudulent conversion of plaintiffs' shares. The Court emphasized that because "[t]he outstanding stock of a corporation is the *individual property* of the shareholders," the corporation "has no interest in it or in dealings among shareholders with respect to their stock." *Id.* (emphasis added). Based on the foregoing, the Court agreed that defendants' act of fraudulently depriving plaintiffs of their stock worked an injury individual to those shareholders. *Id.*

Second, the Court focused on the issuance of new shares to defendants. Those shares came from the corporate treasury, not from plaintiffs. *Id.* Nonetheless, the Court concluded that plaintiffs could maintain a direct action because – "although relating to the stock as a whole" – the fraudulent transfer of those shares "work[ed] an injury to rights belonging to the stockholders individually" when it "oust[ed] the complaining stockholders from their position as controlling shareholders." *Id.* at 131-32.

Because "the gravamen of the pleading" was "injury to plaintiffs as individuals," the Court upheld the plaintiffs' action as "individual and not derivative." *Id.*

2. Missouri Law Recognizes Numerous Examples of When a Shareholder Can Maintain a Direct Action

Under the holding in *Gieselmann*, "[s]tockholders may maintain an action on an individual basis, as distinguished from a derivative action, against directors, officers, or others for the redress of wrongs constituting a *direct fraud* upon them." *Id.* (emphasis added). In *Gieselmann*, the Court identified two additional scenarios that would give rise to an individual action: "wrongfully expelling [the plaintiff]" and "refusing to allow him to inspect the corporate books and records." *Id.* Subsequent decisions by the courts of appeals have embraced – and expanded upon – these scenarios.

For example, relying on *Gieselmann*, the court of appeals in *Place v. P.M. Place Stores Co.* allowed shareholders to sue individually for rescission of a transfer of stock to former shareholders. 950 S.W.2d 862, 865-66 (Mo. Ct. App. 1996). The court of appeals concluded that the shareholders sufficiently alleged a direct injury to them distinct from that suffered by other shareholders, and therefore could maintain an individual action, where they alleged that the unlawful increase of stock "oust[ed] [them] from their position as controlling stockholders." *Id.*

Similarly, in *Dawson v. Dawson*, a shareholder sued individually and derivatively for an injunction and an accounting regarding an alleged illegal stock transfer from a director to another stockholder. 645 S.W.2d 120, 123-24 (Mo. Ct. App. 1982). Relying on *Gieselmann*, the court held that plaintiff's allegation that he was deprived of his right to inspect the corporate books could support an individual action. *Id.* at 125-26.

Finally, in *Massie v. Barth*, the court of appeals allowed an individual action to proceed where there existed a "special obligation" or a "special relationship" between the directors and the shareholders. 634 S.W.2d 208, 211 (Mo. Ct. App. 1982).

These cases demonstrate the Circuit Court's fundamental error. In holding that Nickell's claims could not be brought on an individual basis, the Circuit Court focused on "the absence of a right or special obligation." LF 168. But the assertion of a statutory right or special obligation is not a *sine qua non* to Nickell's ability to bring his claims individually. Rather, under *Gieselmann*, whenever "the injury is done directly to an individual shareholder, director or officer as such, depriving him of his rights," a direct action is permitted. 443 S.W.2d at 131. The precise *nature* of the harm is irrelevant, as long as it is suffered by the shareholder individually. *See, e.g.*, *Grogan v. Garner*, 806 F.2d 829, 836 (8th Cir. 1986) (applying Missouri law) (permitting shareholders to bring an individual suit where the defendant's "fraudulent actions prevented the plaintiffs from realizing the true value of their shares and maximizing that value in the sale").

B. Because Respondents' Conduct Fraudulently Induced Nickell and the Class to Vote Their Shares in Favor of the Merger, Nickell and the Class Suffered an Injury Distinct from the One Suffered by ESSI

Looking at the crux of Nickell's second amended petition and accepting as true his allegations, it is clear that Nickell and the Class suffered an injury distinct from the one suffered by ESSI when Respondents disseminated misleading information in the Registration Statement designed to induce Nickell and the Class to sell their ESSI shares to DRS at a reduced price per share. This conduct amounts to an individual injury for

three reasons. *First*, Respondents' misconduct injured a personal right held by Nickell and the Class—the right to cast their shares in an informed manner and to receive a full and fair merger consideration. *Second*, Respondents' failure to disclose in the Registration Statement their backdating scheme and the secret agreements between DRS and the ESSI Defendants constituted a "direct fraud" upon Nickell and the Class. *Third*, Nickell and the Class can maintain an individual action against Respondents because a special fiduciary duty exists when directors decide to sell the company, which requires them to maximize the value for the shareholders.

1. Respondents' Fraudulent Conduct Injured Nickell's and the Class's Right to Vote Their Shares in an Informed Manner

There is no dispute that, under Missouri law, a direct action exists where shareholders "assert violation of rights individual to them." *Centerre Bank*, 976 S.W.2d at 614; *see also Gieselmann*, 443 S.W.2d at 131 (focusing on whether there was a "direct injury to plaintiffs as individuals"); *Grogan*, 806 F.2d at 834 ("[I]f the injury is one to the plaintiff as a stockholder and to him individually, . . . as where the action is based . . . on a right belonging severally to him . . . , it is an individual action."). In this case, a direct action exists because Respondents' fraudulent conduct injured a right held personally by Nickell and the Class – the right to vote their shares in an informed manner.

The right to vote in an informed way is a distinct individual right. Therefore, where the plaintiffs are persuaded into voting for a merger and tendering stock for a reduced price, on the basis of a deceptive or misleading proxy solicitation, the resulting harm is direct. *See* 12B WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE

LAW OF CORPORATIONS § 5915 (perm. ed., rev. vol. 2009) (individual actions include: "Actions relating to the right to vote at shareholders' meetings" and "Action by shareholder who alleges a deceptive or misleading proxy solicitation" (citing cases)).[10]

When the board of directors solicits the shareholders' vote on a grossly-inadequate merger by way of a misleading registration statement, there is no injury to the corporation. Rather, what has been affected is not a corporate property or right, but the right of shareholders to vote their shares in an informed manner and to receive full value for their shares in the merger. Strong or a weak, such a claim is individual, not corporate. Even if all shareholders have been affected equally, that does not make the claim of improper interference with the right to vote and to receive the merger consideration a corporate claim. *See Gieselmann*, 443 S.W.2d at 131-32; FLETCHER, *supra*, § 5915.

Here, the record is undisputed that Nickell and other shareholders had the right to vote on the merger and that a majority shareholder vote was a condition precedent to the merger. LF 136-139 (¶¶ 57-64). Nickell, not ESSI, owned these voting rights. *See Gieselmann*, 443 S.W.2d at 131 ("The outstanding stock of a corporation is the individual property of the shareholders. It is not the corporation's property and the corporation, as

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[10] This Court and Missouri Courts of Appeals have on numerous occasions relied on Fletcher's Cyclopedia of the Law of Corporations in determining whether the action is direct or derivative. *See, e.g.*, *Gieselmann*, 443 S.W.2d at 131; *Massie*, 634 S.W.2d at 210; *Schick v. Riemer*, 263 S.W.2d 51, 54-55 (Mo. Ct. App. 1953).

such, has no interest in it or in dealings among shareholders with respect to their stock."). Moreover, the second amended petition plainly alleges that Respondents interfered with Nickell's voting rights by soliciting his vote via a materially misleading Registration Statement that concealed the fact that the ESSI Defendants engaged in self-dealing by agreeing to a lower merger consideration in exchange for personal benefits. *See* LF 149 (¶¶ 103-104). Based on this interference with the rights that are uniquely individual, the second amended petition adequately states a direct claim against Respondents.

2. Respondents' Failure to Disclose the Backdating Scheme and the Secret Agreements Amounted to a "Direct Fraud"

"Stockholders may maintain an action on an individual basis, as distinguished from a derivative action, against directors, officers, or others for the redress of wrongs constituting a direct fraud upon them." *Gieselmann*, 443 S.W.2d at 131; *see also Grogan*, 806 F.2d at 834 (same); FLETCHER, *supra*, § 5911 (same). Here, Nickell and the Class can maintain a direct action because Respondents' conduct in urging Nickell and the Class to cast their individual votes in favor of the Merger based on a materially false and misleading prospectus concealed the backdating scheme and the secret agreements and, thus, "constitute[ed] a direct fraud" upon Nickell and the Class.

a. *Gieselmann* Controls

Nickell and the Class are *not* seeking redress for the misappropriation of corporate assets or property or for any wrong suffered by ESSI. Instead, they seek *individual damages* because Respondents deceived them about the circumstances under which DRS agreed to acquire ESSI stock. LF 136-37 (¶¶ 58, 60). Viewed in the light most favorable

to Nickell, at the pleading stage, these allegations give rise to a direct claim because Respondents concealed the existence of (i) the stock-options-backdating scheme and (ii) the secret agreements negotiated between the ESSI Defendants and DRS. *Id.*

Notably, Nickell and the Class allege that they were asked to sell *their stock* for a stated price as represented in DRS's offer and as recommended by the ESSI Defendants – a price that was substantially discounted as a result of Respondents' secret agreements, which were not revealed to Nickell and the Class. LF 138 (¶ 64).

"Silence can be an act of fraud where matters are not what they appear to be and the true state of affairs is not discoverable by ordinary diligence." *Bayne v. Jenkins*, 593 S.W.2d 519, 529 (Mo. 1980). Here, Nickell's allegations of concealment adequately state a "direct fraud" against Nickell and the Class.[11] At all relevant times, "Respondents certainly were in a better position to know the truth than w[ere] [Nickell and the Class] and, accordingly, [Nickell and the Class] had a right to rely upon their statements and representations." *Id.* at 532. Accordingly, because Respondents' conduct constituted a

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[11] Indeed, the Circuit Court *did* find that Nickell adequately alleged fraud against all Defendants except Newman. *See* LF 169-170 (concluding that Nickell adequately alleged that "Defendants prepared the misinformation in the course of their business, that they should have known of the misinformation, that Defendants directly participated in its preparation, that it was provided to Plaintiff and other ESSI shareholders in order to guide them in the particular merger transaction at issue, that Plaintiff's reliance was justifiable and Plaintiff suffered pecuniary loss [as a result]").

"direct fraud" upon Nickell and the Class, Nickell can "maintain an action on an individual basis." *See Gieselmann*, 443 S.W.2d at 131.

b. *Grogan* Provides Further Support

The Eighth Circuit's decision in *Grogan v. Garner*, 806 F.2d 829, applying Missouri law, provides further support that this action can be maintained on an individual basis.[12] In *Grogan*, two shareholders of STI-Missouri brought an action against the company's president arising from the sale of the company to North American Car Corporation ("NACC"). *Id.* at 831. Plaintiffs alleged that in seeking shareholder approval of NACC's offer to purchase all of STI's facilities, defendant never revealed that NACC offered to pay separately for STI-Kansas by a stock exchange and extended an employment offer to defendant. *Id.* at 832-33. Ultimately, NACC swapped shares of its parent corporation, valued at over 2.5 million dollars, for shares of STI-Kansas. *Id.* at 833. On appeal, defendant argued that the plaintiffs had no standing to sue because any injury sustained was to the corporation, requiring a derivative action. *Id.* at 834.

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[12] While federal cases interpreting Missouri law are not binding on this Court, they are persuasive. *Lagares v. Camdenton R-III Sch. Dist.*, 68 S.W.3d 518, 528 (Mo. Ct. App. 2001). This is especially true where the federal court has a chance to analyze a specific set of circumstances on which the Missouri courts have not definitively opined yet. *See Hope v. Nissan N. Am., Inc.*, 353 S.W.3d 68, 75 (Mo. Ct. App. 2011) ("[W]e rely on federal cases where Missouri law has not definitively addressed an issue.").

The Eighth Circuit concluded that because plaintiffs were directly harmed by the misrepresentations, they properly brought the suit on an individual basis. *Id.* at 834-36. In reaching this conclusion, the Eighth Circuit recognized that the plaintiffs were seeking individual damages:

> [Plaintiffs] are not seeking redress for the misappropriation of corporate assets or property or for any wrong suffered by the corporation. Instead, they seek individual damages because Garner *deceived them about the circumstances* under which NACC acquired the STI enterprise. When this evidence is viewed in the light most favorable to the plaintiffs, as we are bound to do, there exists proof of misrepresentation by Garner that the entire consideration to be paid was in exchange for STI-Missouri and the assets of the wheel shop. [Plaintiffs] allege additional evidence of fraud in Garner's failure to inform them of NACC's offer to buy separately the assets of the wheel shop, which was represented by Garner to be unfunded at that time, for an additional 2.5 million dollars.

Id. at 834 (emphasis added). The court then found *Gieselmann* to be controlling. *Id.* at 835. Applying *Gieselmann*, the Eighth Circuit found "little question" that the plaintiffs had standing to sue for their personal harm:

> The plaintiffs were asked to sell their stock for a stated price as represented in Garner's proposal of sale. . . . The shareholders were told that the consideration set forth was the full price to be paid for the STI enterprise, including the "Assets of the wheel shop (Not funded at this time)." This

> was an overall representation that NACC was paying the consideration set forth for all of the assets, including the wheel shop, and that plaintiffs' shares were to be ten percent of the entire consideration paid. [Plaintiffs] had every right to believe that their ten percent interest included the assets of STI-Kansas as well as those of STI-Missouri.

Id. The court concluded by stating that although plaintiffs could have brought a derivative action had they known all the facts, that fact did not affect the validity of their individual action against defendant, which was based "on the direct fraud committed by him when he misrepresented the terms of NACC's offer." *Id.* at 836. "In short, Garner's fraudulent actions prevented the plaintiffs from realizing the true value of their shares and maximizing that value in the sale to NACC." *Id.*

In the present case, the crux of the second amended petition is that Respondents' concealment of misconduct in false and misleading registration statements and prospectuses induced Nickell and the Class to approve DRS's acquisition of ESSI and to sell their individual shares in connection with the Merger. LF 136-139, 149 (¶¶ 57-65, 103-104). Just like in *Grogan*, Nickell and the Class "were asked to sell their stock for a stated price as represented" to them by Defendants. *Compare Grogan*, 806 F.2d at 835, *with* LF 149, 152 (¶¶ 103, 122). In both cases, "[t]he shareholders were told that the consideration set forth was the full price" for their shares, *Grogan*, 806 F.2d at 835, when in fact there were secret agreements negotiated, which benefitted only the defendants and excluded the plaintiffs. *See, e.g.*, LF 135, 139-140 (¶¶ 55, 66-68).

At the end of the day, Respondents' "fraudulent actions prevented [Nickell and the Class] from realizing the true value of their shares and maximizing that value in the sale to [DRS]." 806 F.2d at 836. Nickell and the Class were "directly harmed" by these misrepresentations because they were the ones who owned the stock and had the right to receive the merger consideration. *See Gieselmann*, 443 S.W.2d at 131. Accordingly, under both *Gieselmann* and *Grogan*, this action can be maintained on an individual basis.

3. Respondents Had a Special Fiduciary Duty to Maximize the Value for the Shareholders in the Merger

In negotiating a share price that shareholders will receive in a cash-out merger, directors act as fiduciaries on behalf of the shareholders. *See Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 48-49 (Del. 1994). "[T]he common law imposes on those directors duties to maximize shareholder value and make full disclosure of all material facts concerning the merger to the shareholders." *Shenker v. Laureate Educ., Inc.*, 411 Md. 317, 338-41 (2009); *see also Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (once sale of the company became inevitable, "obtaining the highest price for the benefit of the stockholders should have been the central theme guiding director action").

Accordingly, in selling ESSI to DRS, the ESSI Defendants had a duty of candor and a duty to maximize the value for the shareholders. By focusing on the benefit to themselves at the expense of the shareholders and by failing to maximize the value to the shareholders (*see* LF 135 (¶ 55)), Respondents breached their special fiduciary duties (of candor and maximization of value) owed to Nickell and the Class directly.

In this context, the recent decision by the Maryland's highest court is instructive. There, the shareholders brought claims after the corporation approved a cash-out merger, alleging that the directors "violated the fiduciary duties of candor and maximization of value" resulting in "a lesser value that shareholders received for their shares in the cash-out merger." *Shenker*, 411 Md. at 346. The court held the action to be direct because the fiduciary claims were "based on a breach owed directly to the shareholder[s]" and the injury was "suffered solely by the shareholders and not by [the] corporate entity." *Id.* at 346. The court emphasized that "[a] higher or lower price received by shareholders for their shares in the cash-out merger in no way implicated [the corporation's] interests and causes no harm to the corporation." *Id.* at 346-47.

The same is true here. Nickell and the Class's claims are based on a duty owed directly to them, and the injury was suffered solely by them, because the lower price received in the Merger in no way implicated ESSI's interests and, indeed, caused no harm to ESSI. *See id.*[13] Accordingly, Nickell's claims are direct. *See Parnes v. Bally Entm't Corp.*, 722 A.2d 1243, 1245 (Del. 1999) ("A stockholder who directly attacks the fairness or validity of a merger alleges an injury to the stockholders, not the corporation, and may pursue such a claim even after the merger at issue has been consummated.").

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[13] *See also Lochhead v. Alacano*, 697 F. Supp. 406, 411-12 (D. Utah 1988) (plaintiffs stated an individual injury where their proportionate ownership in the company was diluted, but there was no indication that the overall value of the company at the time of the merger was affected by the defendants' actions).

C. The Fact that Respondents' Conduct also Injured Other Shareholders and ESSI Does Not Defeat the Individual Nature of Nickell's Injury

Respondents are likely to argue that an individual suit can never be maintained if the act that injured the plaintiff *also* injured many other shareholders or the corporation. However, there is no basis under Missouri law for this false dichotomy.

1. Nickell Can Maintain an Individual Suit Even Though Other Shareholders Were Similarly Injured

The 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. Rather, the governing inquiry has always been whether the complaining shareholder suffered an injury that was distinct *from the corporation*. *See, e.g.*, *Centerre Bank*, 976 S.W.2d at 614 ("[I]ndividual actions are permitted, and provide the logical remedy, if the injury is to the shareholders themselves directly, and not to the corporation.").

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. *See, e.g.*, *Dawson*, 645 S.W.2d at 125; *see also Schick*, 263 S.W.2d at 54 (distinguishing between an injury "to the stockholders individually" and one "to the corporation (*i. e.* to the stockholders collectively)"). However, a review of these decisions shows that the courts there merely used the phrase "shareholders collectively" as a synonym for the "corporation." There is no indication that the use of this phrase was meant to imply that the plaintiff's injury must be distinct from that of other shareholders individually.

Indeed, other jurisdictions have expressly rejected the false premise that "a suit must be maintained derivatively if the injury falls equally upon all stockholders." The Supreme Court of Delaware's decision in *Tooley v. Donaldson, Lufkin, & Jenrette* is instructive in this regard:

> Experience has shown this concept to be confusing and inaccurate. It is confusing because it appears to have been intended to address the fact that an injury to the corporation tends to diminish each share of stock equally because corporate assets or their value are diminished. In that sense, the *indirect* injury to the stockholders arising out of the harm to the corporation comes about solely by virtue of their stockholdings. It does not arise out of any independent or direct harm to the stockholders, individually. That concept is also inaccurate because a direct, individual claim of stockholders that does not depend on harm to the corporation can also fall on all stockholders equally, without the claim thereby becoming a derivative claim.

845 A.2d 1031, 1037 (Del. 2004); *see also Shenker*, 411 Md. at 345 ("That the plaintiff suffered his or her injury in common with all other shareholders is not determinative of whether the injury suffered is direct or indirect."); *Jones v. H. F. Ahmanson & Co.*, 1 Cal. 3d 93, 107 (1969) ("The individual wrong necessary to support a suit by a shareholder need not be unique to that plaintiff. The same injury may affect a substantial number of shareholders. If the injury is not incidental to an injury to the corporation, an individual cause of action exists.").

As these decisions demonstrate, where a shareholder individually suffers a direct injury arising out of specific rights derived from his stockholdings (such as shareholder inspection rights, right to dividends, or, as in this case, the right to vote one's shares in an informed manner and to receive the merger consideration), the shareholder can maintain a direct action, regardless of whether the same injury was also suffered by two, ten, or one hundred other shareholders. *See, e.g.*, *Tooley*, 845 A.2d at 1037 ("[A] direct, individual claim of stockholders that does not depend on harm to the corporation can also fall on all stockholders equally, without the claim thereby becoming a derivative claim.").

2. A Shareholder Can Sue to Redress a Direct Injury to Himself Regardless of Whether the Same Violation Injured the Company

More importantly, derivative and direct actions are not mutually exclusive. Under Missouri law, the mere fact that a claim could *also* have been brought as a derivative action does *not* extinguish the shareholders' right to maintain an individual action if they have also suffered direct injuries. *See, e.g.*, *Massie*, 634 S.W.2d at 210 ("'A stockholder may sue to redress direct injuries to himself regardless of whether the same violation injured the corporation.'" (citation omitted)); *Grogan*, 806 F.2d at 834 (applying Missouri law) ("[A]n individual stockholder may sue to redress direct injury to himself, even if the same violation also injured the corporation.").[14]

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[14] Other jurisdictions agree. *See, e.g.*, *Shenker*, 411 Md. at 345 ("[A] shareholder may bring a direct action, either individually or as a representative of a class, against alleged corporate wrongdoers when the shareholder suffers the harm directly or a duty is

This rule is settled: "An individual cause of action can be asserted when the wrong is both to the shareholder and to the corporation." 12B FLETCHER, *supra*, §§ 5908, 5911 (citing cases); *see also id.* § 5921 ("A shareholder may sue as an individual where the act complained of creates not only a cause of action in favor of the corporation but also creates a cause of action in favor of the shareholder as an individual . . . .").

Accordingly, the fact that a derivative action could also be brought on behalf of ESSI to recover for any damage to the company does not – and cannot – defeat Nickell's individual action for the injuries that he and the Class suffered directly.

* * *

Applying *Gieselmann*, *Centerre Bank*, and *Grogan*, the Court of Appeals correctly determined that Respondents' concealment of the options-backdating scheme and of the secret agreements underlying the sale of ESSI to DRS induced Nickell and the Class to approve the Merger and to sell their individual shares. *Nickell*, slip op. at 8. Respondents' conduct affected Nickell's and the Class's individual right to vote their shares in an informed manner and constituted a direct fraud upon Nickell and the Class. Respondents also breached their special fiduciary duties of candor and maximization of value owed to Nickell and the Class directly. Because the injury suffered by Nickell and

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owed directly to the shareholder, though such harm also may be a violation of a duty owing to the corporation."); *Jensen v. Voyles*, 393 F.2d 131, 133 (10th Cir. 1968) ("[T]the majority rule permits a stockholder who has been individually injured to sue in his own right even if the corporation is also injured." (citing cases)).

the Class is distinct from any injury suffered by ESSI, this action can properly be maintained on an individual basis. Accordingly, this Court should reverse the Circuit Court's erroneous dismissal of Nickell's counts I, II, and III.

II. As an Alternative Ground for Reversal, the Circuit Court Erred in Dismissing as Derivative Counts I, II, and III Because a Direct Claim Exists Where It Is Alleged that the Corporation's Controlling Shareholders Breached Their Fiduciary Duties, and in this Case the Petition Adequately Alleges that the ESSI Defendants Qualify as Controlling Shareholders and that They Did Breach Their Fiduciary Duties.

In the alternative, under Missouri law, Nickell's claims are direct because the petition adequately alleges a special fiduciary relationship between the ESSI Defendants (as controlling shareholders) on the one hand and Nickell and the Class on the other. *See Gieselmann*, 443 S.W.2d at 131 (stockholder has the right to maintain an individual action when the "erring director or officer owes [him] a *special fiduciary duty*" (emphasis added)); *Centerre Bank*, 976 S.W.2d at 614 ("Despite [the] general rule, there are certain situations in which a statutory right or *special obligation* may give a shareholder standing to maintain an action in his or her own right." (emphasis added)). This provides an independent ground to reverse the Circuit Court's dismissal of counts I, II, and III.

A. The Second Amended Petition Adequately Alleges that the ESSI Defendants Were Controlling Shareholders Because They Were in *De Facto* Control of ESSI and Because They Caused ESSI to Engage in the Challenged Wrongful Transactions

As the Supreme Court noted more than 70 years ago, dominant or controlling shareholders (or a group of shareholders) owe fiduciary duties to the remaining shareholders. *Pepper v. Litton*, 308 U.S. 295, 307 (1939). This point is also well settled in Missouri. *See, e.g.*, *Peterson v. Cont'l Boiler Works, Inc.*, 783 S.W.2d 896, 904 (Mo. 1990) ("We recognize that majority shareholders owe a fiduciary duty to minority shareholders."); *Bayne*, 593 S.W.2d at 532 (same).

As a result, "the law imposes equitable limitations on the rights of dominant shareholders to act in their own self-interest. Shareholders in control are under a fiduciary duty to refrain from using their control to obtain a profit for themselves at the injury or expense of the minority, or to produce corporate action of any type that is designed to operate unfairly to the minority." *Fix v. Fix Material Co.*, 538 S.W.2d 351, 358 (Mo. Ct. App. 1976); *see also Bayne*, 593 S.W.2d at 532 ("A group of stockholders who act together to exercise effective control over a corporation . . . are generally considered trustees, with the attendant duties of trustees towards the beneficiaries, *i. e.*, the minority stockholders." (internal citations and quotation marks omitted)).

Here, the ESSI Defendants were the controlling shareholders for three reasons. *First*, the second amended petition specifically alleges that the ESSI Defendants effectively controlled the corporation's board of directors and its Compensation

Committee. LF 122 (¶ 29) ("During 2002, half of the Compensation Committee and board members were individuals related by blood to Shanahan Sr., including his son Shanahan Jr. and Shanahan Jr.'s father-in-law Earl Wims, while other members of the ESSI Board had close personal and business ties to Shanahan."). At the pleading stage, these allegations must be accepted as true. *See Lynch*, 260 S.W.3d at 836.

Second, Missouri courts have frequently found such *de facto* control over the corporation to be sufficient to qualify as a controlling shareholder. For example, in *Bayne*, even though defendants owned only 42% of the company, the Court nevertheless concluded that they "had acted as a bloc to exercise effective control" over the company and, therefore, owed fiduciary duties to the *de facto* "minority" shareholders. 593 S.W.2d at 529. Similarly, in *Whale Art Co. v. Docter*, the court held that a 49% shareholder was in *de facto* control of the corporation, and therefore a controlling shareholder, where that shareholder had "exclusive control over the accounts and sales of the corporation," decided not to pay another shareholder a bonus in one year, and "set his own salary at $10,000 per year." 743 S.W.2d 511, 514 (Mo. Ct. App. 1987). Under *Bayne* and *Whale Art*, the ESSI Defendants qualify as "controlling" shareholders and, therefore, owed special fiduciary duties to Nickell and the Class.

Third, the second amended petition alleges that the ESSI Defendants granted themselves illegal backdated stock options and, when the backdating scheme was about to collapse, quickly negotiated the sale of ESSI to DRS, which benefitted them tremendously at the expense of a depressed merger price for the other shareholders. LF 125-130, 133-136 (¶¶ 37-42, 51-56). These allegations of fraud and manipulations are

sufficient to qualify the ESSI Defendants as controlling shareholders. *See, e.g.*, *Dubroff v. Wren Holdings, LLC*, C.A. Nos. 3940–VCN, 6017–VCN, 2011 WL 5137175, at *7 (Del. Ch. Oct. 28, 2011) (plaintiffs sufficiently pled that certain defendants formed a "control group" where they alleged that: (1) those defendants "acting as a single group ... planned and caused [the company] to engage in a series of transactions . . . that had the purpose and effect of enriching [those defendants] at the expense of the minority shareholders" and (2) "throughout a series of ensuing meetings . . . [those defendants] worked together to establish the exact terms and timing of [those transactions]").

B. Because the ESSI Defendants (as Controlling Shareholders) Owed Special Fiduciary Duties to Nickell and the Class, Nickell's Claims Against Them Can Be Asserted on an Individual Basis

Missouri courts have recognized that where a special fiduciary relationship exists, such as the one between a controlling shareholder and other shareholders, the aggrieved shareholders can assert a direct claim against the defendants. *See Gieselmann*, 443 S.W.2d at 131; *Centerre Bank*, 976 S.W.2d at 614. Here, because the ESSI Defendants qualify as controlling shareholders, they owed special fiduciary duties to Nickell and the Class. As a result, Nickell's claims for breach of fiduciary duties, aiding and abetting, and unjust enrichment could properly be alleged on an individual basis. The Circuit Court's contrary conclusion dismissing these claims requires a reversal.

III. The Circuit Court Erred in Dismissing Count I for Failure to Allege the Necessary Element of Duty Because a Fiduciary Relationship Extends to the Shareholders Individually if the Directors and Officers Violated Rights Individual to the Shareholders that Injured the Shareholders Directly, and in this Case the Fiduciary Relationship Is Present Because Nickell and the Class Suffered an Injury Distinct from the One Suffered by ESSI.

The Circuit Court erred in concluding that Nickell failed to allege the necessary element of duty with respect to his breach-of-fiduciary-duty claim (count I). To properly plead a claim for breach of fiduciary relationship, the plaintiff must allege: "(1) the existence of a fiduciary relationship between the parties, (2) a breach of that fiduciary duty, (3) causation and (4) harm." *Koger v. Hartford Life Ins. Co.*, 28 S.W.3d 405, 411 (Mo. Ct. App. 2000). Here, the Circuit Court dismissed count I for failure to allege the first element (existence of fiduciary duty). Notably, this alternative basis for dismissal was premised on *legal* – rather than factual – grounds. *See* LF 169. Contrary to the Circuit Court's conclusion, three grounds support the finding of a fiduciary duty.

First, Missouri law is clear that an officer or director of a corporation has a fiduciary duty to protect the interests of the corporation. *Bayne*, 593 S.W.2d at 532; *Gieselmann*, 443 S.W.2d at 136. While the duty is usually to the shareholders as a whole, it does extend to the shareholders individually if the directors or officers violated rights individual to the shareholders that injured the shareholders directly. *See Dawson*, 645 S.W.2d at 125 ("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. . . . Where a complaint relates to the direct injury of the plaintiff, however, a derivative action may not be necessary."); *see also Gieselmann*, 443 S.W.2d at 131; *Centerre Bank*, 976 S.W.2d at 614.

For the reasons set forth in Point I above, Nickell's second amended petition alleges that the ESSI Defendants' breaches of fiduciary duties violated rights individual to Nickell and the Class that injured them directly. Accordingly, the second amended petition contains allegations that the fiduciary duties owed by the ESSI Defendants extended to Nickell and the Class individually. *See Dawson*, 645 S.W.2d at 125.

Second, fiduciary duties of officers and directors also extend to the shareholders individually when there is a special relationship alleged. *See Gieselmann*, 443 S.W.2d at 131; *Centerre Bank*, 976 S.W.2d at 614. Here, as discussed in Point II above, the ESSI Defendants were the *de facto* controlling shareholders. *See Bayne*, 593 S.W.2d at 532; *Fix*, 538 S.W.2d at 358. As controlling shareholders, the ESSI Defendants owed Nickell and the Class special fiduciary duties that extended to them individually.

Third, a fiduciary duty exists under the specific circumstances of this case. "A legal duty owed by one to another may arise from at least three sources: (1) it may be proscribed by the legislative branch; (2) it may arise because the law imposes a duty based on the relationship between the parties *or because under a particular set of circumstances an actor must exercise due care to avoid foreseeable injury*; or (3) it may arise because a party has assumed a duty by contract (agreement) whether written or oral." *Robert T. McLean Irrevocable Trust v. Patrick Davis, P.C.*, 283 S.W.3d 786, 793 (Mo. Ct. App. 2009) (emphasis added). In this case, when the ESSI Defendants chose to

engage in illegal backdating and then decided to insulate themselves from any liability by selling the company to DRS, the fiduciary duties they owed to the shareholders *as a whole* were extended to the shareholders *individually*. Specifically, the ESSI Defendants were then under the obligation to "exercise due care to avoid foreseeable injury" (such as a depressed or diluted merger price) to the individual shareholders. *See id.* This satisfies the necessary element of duty.

For the foregoing reasons, the Circuit Court erred in dismissing count I for failure to state a claim on the ground that Nickell failed to allege the element of duty.

CONCLUSION

Because this action involves a straight-forward application of settled Missouri law and because the Court of Appeals, Eastern District faithfully applied this Court's precedent in *Gieselmann*, the Court should adopt in full the reasoning of the Court of Appeals, as set forth in the June 4, 2013 opinion. Consistent with that opinion, this Court should reverse the Circuit Court's erroneous dismissal of counts I, II, and III, and remand this action to allow Nickell to prosecute his meritorious claims.

Indeed, because Missouri law is so well settled, reexamination of the Court of Appeals' well-reasoned opinion is unnecessary. The Court should therefore retransfer the case to the Court of Appeals on the ground that the transfer was improvidently granted. *See* Rule 83.09; *see also State v. Watson*, 603 S.W.2d 530, 532 (Mo. banc 1980).

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Respectfully submitted,

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CERTIFICATE OF COMPLIANCE WITH RULE 84.06(C)

I, Timothy J. Becker, certify that:

1. This brief includes the information required by Rule 55.03.

2. This brief complies with the limitations contained in Rule 84.06(b).

3. There are 11,750 words contained in this brief.

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CERTIFICATE OF SERVICE

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