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

APPELLANT'S SUBSTITUTE REPLY BRIEF

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Dated: April 21, 2014

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ARGUMENT[1]

I. The Court Should Reverse Because Nickell and the Class Have Suffered an Injury Separate and Distinct from Any Harm Suffered by ESSI and, as a Result, Have Adequately Stated a Direct Claim

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*). Respondents concede that *Gieselmann* is the Court's only decision on this issue.

Nonetheless, Respondents attempt to erode the rule in *Gieselmann* by narrowly reading the decision and by misinterpreting subsequent court-of-appeals decisions. The Court should reject these attempts because Missouri law does not place any arbitrary limitations on the types of claims giving rise to a direct action.

Respondents' attempts to distinguish *Gieselmann* fare no better. Under the well-settled framework established in *Gieselmann*, Nickell and the Class's claims are individual and can be maintained as a direct action. Numerous Missouri decisions and

[1] This brief utilizes the same abbreviations as in Appellant's Substitute Brief ("ASB"). The Joint Substitute Brief of Kenneth E. Lewi *et al.* is cited as "Joint Br." Newman's Substitute Brief is cited as "Newman's Br." Shanahan, Sr. (who previously filed a joinder in Shanahan, Jr.'s now-superseded brief) did not file a substitute brief.

the on-point decision of the U.S. Court of Appeals for the Eighth Circuit (applying Missouri law) confirm this conclusion.

Finally, the Court should reject Respondents' efforts to mischaracterize both Nickell's factual allegations and the basis of relief sought in his petition. 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'[s] acquisition of ESSI and sell their individual shares in connection with the acquisition." *Nickell v. Shanahan*, No. ED 99163, slip op. at 8 (Mo. Ct. App. June 4, 2013). The alleged injury is the right of Nickell and other shareholders to cast their shares in an informed manner and to receive a full and fair merger consideration; it is *not* (as Respondents maintain) the backdating of the stock options or some sort of an "overcompensation claim." This right is individual to Nickell and the Class, *not* the corporation. The fact that a similar injury was also suffered by many (but not all) other ESSI shareholders or that the misconduct also injured ESSI does *not* defeat the individual nature of the injury.

Accepting Nickell's allegations as true, as the Court must at the pleading stage, Nickell has adequately alleged that he and the Class suffered an injury that was distinct from the one suffered by the corporation. Thus, Nickell can maintain a direct action, and the Circuit Court's contrary conclusion must be reversed.

A. Missouri Cases Require that, for the Plaintiff to Maintain a Direct Action, the Injury Suffered Must Be Distinct from the One Suffered by the Corporation, Not the One Suffered by Other Shareholders

Contrary to Respondents' suggestions, the inquiry to determine whether Nickell's injury is direct or derivative is *not* whether the harm suffered by Nickell is distinct from the harm suffered by *other shareholders*. Rather, the correct inquiry is whether Nickell suffered an injury that is distinct from the injury suffered by *the corporation*. *See, e.g.*, *Gieselmann*, 443 S.W.2d at 131 (finding a direct claim where the alleged misconduct "affected [the plaintiff] directly and individually, and not the corporation"); *Grogan v. Garner*, 806 F.2d 829, 834 (8th Cir. 1986) (same).[2]

Telling, Respondents fail to cite any Missouri case holding that the injury must be distinct from that of other shareholders. Rather, the cases cited by Respondents stand for the well-settled proposition that a direct action can be maintained when the injury to the shareholders individually is distinct from the injury *to the corporation*. *See, e.g.*, *Centerre Bank of Kansas City, N.A. v. Angle*, 976 S.W.2d 608, 614 (Mo. Ct. App. 1998) ("[I]ndividual actions are permitted . . . if the injury is to the shareholders themselves directly, and not to the corporation."); *Place v. P.M. Place Stores Co.*, 950 S.W.2d 862, 865 (Mo. Ct. App. 1996) (distinguishing between an injury "to the shareholders individually" and one "to the corporation, *i.e.* to the shareholders collectively"); *Dawson*

[2] Unless otherwise noted, all emphasis has been added and all citations and internal quotation marks have been omitted.

v. Dawson, 645 S.W.2d 120, 125 (Mo. Ct. App. 1982) (same); *Schick v. Riemer*, 263 S.W.2d 51, 54 (Mo. Ct. App. 1953) (same).

Respondents' argument that a direct injury becomes "derivative" when other shareholders are similarly injured is flawed. Such a transformation finds no support in Missouri law. Indeed, numerous other jurisdictions have expressly rejected this false premise advocated by Respondents. *See* ASB at 32-34 (discussing cases).[3]

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[3] One of cases cited in Appellant's Substitute Brief is *Tooley v. Donaldson, Lufkin, & Jenrette*, 845 A.2d 1031 (Del. 2004). Contrary to Respondents' suggestions, Nickell's citation to *Tooley* and several other non-Missouri cases is not meant to rely on the laws of those states to state a claim; rather, it is meant to demonstrate that numerous jurisdictions have rejected Respondents' deficient arguments.

In any event, *Tooley* is consistent with Missouri law. In *Tooley*, the Delaware Supreme Court clarified Delaware law, observing that the analysis for distinguishing between direct and derivative actions must be based solely on the following two questions: "(1) who suffered the alleged harm," and "(2) who would receive the benefit of any recovery?" *Id.* at 1035. In summarizing Missouri law, *Centerre Bank* announced a substantially similar test. *See* 976 S.W.2d at 614 (noting that Missouri cases, including *Gieselmann*, *Dawson*, and *Place*, "illustrate that individual actions are permitted, and provide the logical remedy, if [(1)] the injury is to the shareholders themselves directly, and not to the corporation. In such cases, [(2)] any recovery would belong to the shareholder so the shareholder has the right to sue individually.").

1. The Class Action Allegations Do Not – and Cannot – Determine Whether the Action Is Direct or Derivative

Respondents' attack on Nickell's class-action allegations is a red herring. Respondents argue that because Nickell *brought this case as a class action on behalf of ESSI shareholders collectively* and because Nickell alleges that *his claims are "typical" of the other shareholders*, then the action *must* be derivative. *See* Joint Br. at 12-15. No legal support is provided for this argument. Moreover, this argument creates an impermissible "Catch-22," whereby no class action can ever be maintained for directors' and officers' breaches of fiduciary duties that harm shareholders directly.

For a class action to be certified, the plaintiff *must* demonstrate that his claims are "typical" of the other class members' claims and that "common" issues of fact or law "predominate." MO. SUP. CT. R. 52.08. Under Respondents' proposed test, the Court would be required to treat as derivative *any* proposed class action, regardless of whether the plaintiff and the proposed class members individually suffered an injury distinct from that suffered by the corporation. This is not the rule. Indeed, every day many class-action lawsuits are filed and litigated asserting direct claims arising out of the directors' and officers' breaches of fiduciary duties in the context of a merger. *See, e.g.*, *Parnes v. Bally Entm't Corp.*, 722 A.2d 1243 (Del. 1999); *Schuster v. Gardner*, 319 F. Supp. 2d 1159 (S.D. Cal. 2003); *see also* 12B WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS §5908 (perm. ed., rev. vol. 2009) ("shareholders with individual claims may have the benefits of the class action device").

Absurd and impractical, Respondents' argument should be rejected. *See Tri-State Gas Co. v. Kansas City S. Ry. Co.*, 484 S.W.2d 252, 255 (Mo. 1972).

2. The ESSI Defendants Did Not Suffer the Same Injury

Respondents say that the ESSI Defendants were harmed "in the same fashion" as Nickell and the Class. *See* Joint Br. at 16 n.6. But nothing is farther from the truth. As explained in Appellant's Substitute Brief, the ESSI Defendants' 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. ASB at 23-25. Moreover, by failing to disclose their backdating scheme and secret agreements, the ESSI Defendants perpetrated a "direct fraud" upon Nickell and the Class. ASB at 25-30.

Because the ESSI Defendants disseminated the false and misleading statements (*see* LF124, 136-137, 139 (¶¶34, 58, 60, 65)), they cannot claim to have suffered any interference with *their* right to cast *their* shares in an informed manner. More importantly, the ESSI Defendants engaged in the improper stock-options backdating and benefitted from the secret agreements with DRS. *See* LF123-124, 125-132, 135, 139-140 (¶¶31, 33, 37-47, 55, 66-68). In light of their own participation in the undisclosed conduct, the ESSI Defendants have no basis to suggest there was any fraud against them.

As wrongdoers, the ESSI Defendants did not suffer the same – or even remotely similar – injury as did Nickell and the Class. Thus, this case can properly be maintained as a direct action.

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

Respondents fail to acknowledge that direct and derivative actions are *not* mutually exclusive. 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 for their direct injuries. *See Massie v. Barth*, 634 S.W.2d 208, 210 (Mo. Ct. App. 1982) ("'A stockholder may sue to redress direct injuries to himself regardless of whether the same violation injured the corporation.'"); *Grogan*, 806 F.2d at 834 (same); *see also* ASB at 34 n.14, 35 (discussing additional authorities).

C. A Direct Action Is Appropriate Because Nickell and the Class Suffered an Injury Distinct from the One Suffered by ESSI

In arguing that Nickell and the Class did not suffer a distinct and individual injury, Respondents focus on the SAP's allegations of stock-options backdating.[4] However, while egregious, those allegations are not the gravamen of the alleged injury. Rather, the crux of the SAP is that Respondents *concealed* this misconduct in ESSI's financial statements in order to *induce* Nickell and the Class to approve the Merger and to sell their *individual* shares in connection with the acquisition. *See* LF149 (¶¶103-104); *see also*

[4] Although "[b]ackdating options is not itself illegal . . . [nor] . . . improper," the backdated options must be properly recorded in the company's financial reports. *See S.E.C. v. Shanahan*, 646 F.3d 536, 540 (8th Cir. 2011). Here, the backdated options were improperly granted and recorded. *See* LF125-132 (¶¶37-47).

Nickell, slip op. at 8. As explained in detail in Appellant's Substitute Brief, this is a direct claim because: (1) it injured Nickell's and the Class's right to vote in an informed manner; (2) it amounted to a "direct fraud" on Nickell and the Class; and (3) a special fiduciary duty existed when the ESSI Defendants decided to sell ESSI. ASB at 22-31.

1. *Gieselmann* Controls

The Court should reject Respondents' attempts to limit *Gieselmann* to "violation[s] of a statutory right or special obligation." *See* Joint Br. at 22. Missouri law does not place any limitations on the types of claims giving rise to a direct action. Rather, *Gieselmann* permits a direct action whenever "the injury is done directly to an individual shareholder, director or officer as such, depriving him of his rights." 443 S.W.2d at 131. The precise *nature* of the harm is irrelevant.

Respondents' efforts to distinguish *Gieselmann* are similarly suspect. In *Gieselmann*, the Court dealt with injuries arising from: (1) the cancellation and reissuance of plaintiffs' certificates of stock; and (2) defendants' issuance to themselves of additional certificate of stock. 443 S.W.2d at 131. With regard to the second injury, the shares came from the corporate treasury, not from the plaintiffs, and thus "relat[ed] to the stock as a whole." *Id.* Nonetheless, the Court concluded that plaintiffs could maintain a direct action because the transfer of those shares "work[ed] an injury to rights belonging to the stockholders individually." *Id.* at 131-32.

Similarly, here, although Nickell's and the Class's injury is tangentially related "to the stock as a whole," the Court of Appeals properly concluded that it could be maintained as a direct action because the false and misleading statements made in the

registration statements and prospectuses "work[ed] an injury to rights belonging to [Nickell and the Class] individually." *See id.*

2. *Grogan* Provides Further Support

Respondents ignore *Grogan*, arguing that Nickell cites no case in support of the rule that a direct action exists under the circumstances of this action. In *Grogan*, the court held that shareholders could maintain an individual action alleging breach of fiduciary duties based on defendant's misrepresentation of the terms of the sale, which induced plaintiffs to vote in favor of the sale and to sell their stock. 806 F.2d at 834-36. As the Court of Appeals in this case recognized, *Grogan* supports Nickell's position. *See Nickell*, slip op. at 8; *see also* ASB at 27-30.[5]

Respondents' attempts to cast doubt on *Grogan* are unpersuasive. The reliance on *Gray v. Bicknell*, 86 F.3d 1472 (8th Cir. 1996), is misplaced because the dismissed claim there did *not* involve fraud – an element found to be essential in *Grogan*. *Compare*

[5] Respondents mischaracterize the facts in *Grogan*. In *Grogan*, the shareholders were misled *before* they voted when the defendant concealed that: (1) the wheel shop has been incorporated; (2) he has decided to sell STI-Kansas stock for one dollar per share and employment commitments to certain hand-picked employees; and (3) the purchaser has agreed to pay separate consideration for STI-Kansas. 806 F.2d at 833. Similarly, Nickell and the Class were misled when the ESSI Defendants concealed the following: (1) the backdating scheme that lowered the overall compensation; and (2) the separate consideration in the form of secret agreements. *See* LF136-138 (¶¶58, 60, 64).

Grogan, 806 F.2d at 836 ("[T]his action does not turn solely on [defendant's] misappropriation of wheel shop assets *but on the direct fraud committed by him* when he misrepresented the terms of NACC's offer."), *with Gray*, 86 F.3d at 1488 (plaintiffs' claim rested solely "on the assertion that Bicknell failed to properly oversee and direct RMR," causing the company to enter bankruptcy").[6]

The reliance on *Arent v. Distribution Sciences, Inc.*, 975 F.2d 1370 (8th Cir. 1992), is similarly misplaced. *Arent* applied Minnesota, not Missouri, law. *Id.* at 1372. Moreover, in *Arent*, the plaintiffs merely alleged that defendant "caused [the corporation] to reject a merger and fail to pursue other financial assistance," which ultimately led to the corporation's bankruptcy. *Id.* The court concluded that any injury was indirect because all that the plaintiffs have alleged was "lost profit opportunity." *Id.* at 1373.

In contrast, Nickell and the Class allege that: (1) Respondents divested Nickell and the Class of their ESSI stock by urging them to vote in favor of the merger by disseminating a false and misleading registration statement that concealed the backdating scheme and the secret agreements; and (2) as a result, Nickell and the Class tendered their ESSI stock for a substantially-reduced price. LF149 (¶¶103-104). On these facts, *Gray* and *Arent* are inapposite, and the Court should follow *Grogan*.

[6] *Grogan* is consistent with *Gieselmann*, where this Court held that a direct action exists for a "direct fraud" against stockholders. 443 S.W.2d at 131.

3. Deprivation of the Right to Vote

Respondents do not dispute that the right to vote in an informed way is a distinct individual right. Nor do they dispute that individual actions may be properly brought to vindicate "the right to vote at shareholders' meetings" and to remedy "a deceptive or misleading proxy solicitation." *See* FLETCHER, *supra*, §5915 (citing cases). Rather, Respondents argue there is no *cause of action* for injury to the "right to vote shares in an informed manner." This argument is misplaced.

At the outset, the *cause of action* advanced is for breach of fiduciary duties, which is premised on the ESSI Defendants' dissemination of false and misleading statements designed to induce Nickell and the Class to vote in favor of the Merger. LF149 (¶¶103-104).[7] Addressing a similar situation, the court in *Grogan* held that shareholders could maintain an individual suit alleging breach of fiduciary duties based on defendant's misrepresentation of the terms of the sale, which induced plaintiffs to vote in favor of the sale and to sell their stock. *See* 806 F.2d at 834. In so holding, the court noted the allegations of "direct fraud committed by [defendant] when he misrepresented the terms of NACC's offer." *Id.* at 836. Applying *Gieselmann*, the court found "little question" that the plaintiffs could bring a direct action. *Id.* at 835. The same is true here.

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[7] This argument is part of the petition and was raised before the Court of Appeals. *See* LF149 (¶¶103-104); Reply Br. at 13-14. Indeed, the Court of Appeals explicitly held that "[t]he crux" of the SAP was Respondents' concealment of the backdating that induced Nickell and the Class to approve the Merger. *See Nickell*, slip op. at 8.

4. Duty of Maximization and Full Disclosure

In entering into the Merger with DRS, the ESSI Defendants owed a duty to "maximize shareholder value" and "make full disclosure of all material facts" to the shareholders. *See, e.g.*, *Shenker v. Laureate Educ., Inc.*, 411 Md. 317, 338-41 (Md. Ct. App. 2009); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).[8]

Respondents rely on *Grogan v. O'Neil*, 307 F. Supp. 2d 1181 (D. Kan. 2004), and *Stender v. Cardwell*, No. 07-cv-2503-REB-MJW, 2010 WL 1930260 (D. Colo. May 12, 2010), to distinguish *Shenker*. *O'Neil* is inapposite, however, because the plaintiff there did not allege any "specific injury that he suffered" other than a reduced stock price. 307 F. Supp. 2d at 1189. This contrasts with Nickell's allegations that he and the Class were injured by Respondents' concealment of the backdating and the secret agreements. *See* LF149-150 (¶¶13-104, 107). Likewise, *Stender* is inapposite because the plaintiffs there failed to allege that the duties of candor and maximization were breached. 2010 WL 1930260, at *4. That is not the case here. *See* LF135-136, 141-142, 149 (¶¶55, 58, 74, 105) (addressing Respondents' duty of maximization).

[8] Contrary to Respondents' arguments, both the SAP and the briefing before the Court of Appeals addressed this theory. *See* LF135-136, 141-142, 149 (¶¶55, 58, 74, 105); *see also* Opening Br. at 33-34; Reply Br. at 14-15.

D. Criminal and Regulatory Enforcement Actions Against the ESSI Defendants Support – Rather than Detract from – Nickell's Allegations

Respondents admit that backdating occurred at ESSI and that some of the ESSI Defendants were forced to disgorge their ill-gotten proceeds. For the first time, however, Respondents seek dismissal of Nickell's petition on the purported ground that Nickell and the Class have already received the benefit of restitution awarded to DRS. *See* Joint Br. at 20-21. No law or logic supports this argument.

At the outset, the Court should refuse to consider this argument because it was not raised in the Circuit Court. Contrary to Respondents' suggestion, the decision below cannot be affirmed on *any ground* presented by the record; rather, it can be affirmed only on *what was raised in the underlying motions to dismiss*. *See In re Estate of Austin*, 389 S.W.3d 168, 171 (Mo. banc 2013). As one court observed, "[t]he full statement of th[e] rule . . . is that the order must be affirmed, if the dismissal of an action can be sustained on any ground *which is supported by the motion to dismiss*." *Prop. Exch. & Sales, Inc. v. King*, 822 S.W.2d 572, 574 (Mo. Ct. App. 1992). Here, because Respondents never raised the restitution-based argument before the Circuit Court or the Court of Appeals, the Court should not consider it. *See also* MO. SUP. CT. R. 83.08(b) (the substitute brief "shall not alter the basis of any claim that was raised in the court of appeals").

In any event, this argument fails on the merits. In March 2007, the U.S. Attorney's Office indicted Shanahan, Sr. and Gerhardt. LF144 (¶84). Pleading guilty, Shanahan, Sr. and Gerhardt agreed to pay $7.87 million and $1.8 million, respectively, in restitution to DRS. *Id.* (¶85).

This restitution does not – and cannot – prevent Nickell from proceeding with a direct action for three reasons. First, the restitution was against only two of the ten ESSI Defendants. Second, the restitution was paid to DRS, not to Nickell or other shareholders directly. Third, no attempt is made to show how the restitution obtained compares to the relief requested. In addition to equitable and injunctive relief, the SAP seeks: (a) damages sustained as a result of defendants' misconduct; (b) punitive damages; and (c) disgorgement of all profits and benefits. LF153-154. At most, the restitution paid to DRS would resemble "disgorgement." It would not, however, satisfy Nickell's request for compensatory and punitive damages.

The Court should reject Respondents' argument as waived and baseless.

E. Nickell Is Not Estopped from Proceeding with a Direct Action

Equally misguided is the assertion that judicial estoppel prevents Nickell from bringing an individual action. *See* Joint Br. at 20 n.8. At the outset, this argument is waived because it was not raised below. *See Prop. Exch.*, 822 S.W.2d at 574; MO. SUP. CT. R. 83.08(b). Moreover, no attempt is made to establish each element of judicial estoppel. *See Miller v. Pool & Canfield, Inc.*, 800 S.W.2d 120, 124 (Mo. Ct. App. 1990).

In any event, "the admissions made by a pleader in one count or plea are not admissible against him on an issue raised by his denials or averments made in another count or plea. In other words, where inconsistent counts or defenses are pleaded, the admissions in one of them cannot be used to destroy the effect of the other." *Luyties Pharmacal Co. v. Frederic Co.*, 716 S.W.2d 831 (Mo. Ct. App. 1986). Thus, to the extent Nickell's allegations in his prior complaint on behalf of DRS are inconsistent with

the allegations in this action, the Court cannot consider the prior allegations against Nickell. *See Joseph v. Marriot Int'l*, 967 S.W.2d 624, 630 (Mo. Ct. App. 1998) (applying the rule and ignoring the contradicting allegations in defendant's third-party petition).

F. Even if Certain Allegations Can Be Viewed as Giving Rise to a Derivative Claim, the Court Should Reverse Because the Gravamen of the Petition Is an Injury to Nickell and the Class Individually

In *Gieselmann*, even though some of the allegations were more "appropriate to a derivative action," the Court allowed plaintiffs to maintain an individual action because "[t]he gravamen of the pleading . . . [was] injury to plaintiffs as individuals." 443 S.W.2d at 131. Here, even if some of the allegations (*i.e.*, backdating or overcompensation) are appropriate for a derivative action (they are not), the Court should nonetheless permit a direct action to proceed because the gravamen of the pleading is injury to Nickell and the Class individually. *See* ASB at 22-31; *see also Nickell*, slip op. at 8.

* * *

For the foregoing reasons, the Court should allow Nickell to maintain a direct action and reverse the dismissal of counts I, II, and III.

II. As an Alternative Ground, the Court Should Reverse Because Nickell and the Class Suffered a Direct Injury When the ESSI Defendants Breached Their Duties as Controlling Shareholders[9]

In arguing that they were not "controlling" shareholders, Respondents raise factual issues on appeal. But factual determinations are improper at the pleading stage, where the Court must accept as true Nickell's allegations of the ESSI Defendants' control. *See Lynch v. Lynch*, 260 S.W.3d 834, 836 (Mo. banc 2008).

Moreover, the ESSI Defendants can be treated as controlling shareholders due to their *de facto* control over ESSI. *See Bayne v. Jenkins*, 593 S.W.2d 519, 532 (Mo. banc 1980); *Whale Art Co. v. Docter*, 743 S.W.2d 511, 514 (Mo. Ct. App. 1987). Indeed, as Respondents concede, although the defendants in *Bayne* owned 42% of the company, the court nevertheless concluded they "had acted as a bloc to exercise effective control" and, thus, owed fiduciary duties to the *de facto* "minority" shareholders. 593 S.W.2d at 532.

Similarly, in *Whale*, the breaching shareholder was considered a "controlling" shareholder, even though he owned only 49% of the company. 743 S.W.2d at 514. Although the court indicated that it could consider his stake in conjunction with the stake of his sister, who owned 2%, that was *not* necessary because the wrongdoer "exercised *de facto* control over the corporation" by having "exclusive control over the accounts and

[9] This argument was presented to the Circuit Court and the Court of Appeals. *See* LF122, 148 (¶¶29, 101); *see also* Opening Br. at 37-41; Reply Br. at 18-20.

sales," deciding not to pay another shareholder a bonus in one year, and "set[ting] his own salary at $10,000 per year." *Id.*

Applying *Bayne* and *Whale*, Respondents qualify as "controlling" shareholders and, thus, owed special fiduciary duties to Nickell and the Class. *See* ASB at 36-39. A breach of those duties allows a direct action. *See Gieselmann*, 443 S.W.2d at 131.

III. The Court Should Reverse the Circuit Court Because Nickell and the Class Suffered an Injury Distinct from the One Suffered by ESSI and, as a Result, a Fiduciary Duty Extends to Nickell and the Class Individually

For the same reasons as discussed in Point I, Nickell has adequately alleged that Respondents owed him and the Class fiduciary duties. As Missouri courts have recognized, the fiduciary relationship extends to the shareholders individually if the directors or officers violated rights individual to the shareholders that injured the shareholders directly. *See, e.g.*, *Centerre Bank*, 976 S.W.2d at 614; *Dawson*, 645 S.W.2d at 125. Accordingly, for the same reasons that he has adequately stated a direct claim, Nickell has also adequately alleged the element of duty.[10]

[10] Respondents concede that the inquiries under Points I and III overlap. *See* Joint Br. at 44-45. The Court of Appeals likewise concluded. *See Nickell*, slip op. at 9-10.

IV. The Court Should Reject Newman's Improper and Legally-Flawed Jurisdictional Challenge Because the "Delaware Carve-Out" Applies and, as a Result, the Circuit Court Properly Concluded that It Has Jurisdiction

During the course of this case, Respondents have lost *four times* before *three courts* (six judges) on whether Nickell's claims against them fall within the "Delaware carve-out" to the Securities Litigation Uniform Standards Act ("SLUSA"). *See Nickell*, slip op. at 10-12 (Court of Appeals); LF159-61 (Circuit Court), 43-44 (same); SLF483-88 (federal district court). Although *none* of Respondents has appealed from the Circuit Court's ruling on this issue, Newman attempts to re-argue the issue before this Court. Such argument is waived. Even if not waived, it fails on the merits.

SLUSA's savings clause, known as the "Delaware carve-out," preserves state-court jurisdiction in certain instances where the "covered class action . . . is based upon the statutory or common law of the State in which the issuer is incorporated." 15 U.S.C. §78bb(f)(3)(A)(i). In particular, the class action must involve:

> (I) the purchase or sale of securities by the issuer or an affiliate of the issuer exclusively from or to holders of equity securities of the issuer; or
>
> (II) any recommendation, position, or other communication with respect to the sale of securities of an issuer that—
>
> > (aa) is made by or on behalf of the issuer or an affiliate of the issuer to holders of equity securities of the issuer; and

> (bb) concerns decisions of such equity holders with respect to voting their securities, acting in response to a tender or exchange offer, or exercising dissenters' or appraisal rights.

15 U.S.C. §78bb(f)(3)(A)(ii).

Newman does not challenge that this is a "covered class action" based upon the "law of the State [(Missouri)] in which the issuer [(ESSI)] is incorporated." Rather, Newman *only* challenges the application of the savings clause's first and second exceptions, 15 U.S.C. §78bb(f)(3)(A)(ii)(I) and (II).

A. The Savings Clause's First Exception

As Judge Limbaugh correctly held, the savings clause's first exception, 15 U.S.C. §78bb(f)(3)(A)(ii)(I), applies because this action involves the purchase of securities of ESSI by an "affiliate" – DRS. SLF486. In a similar case involving a merger, the court in *Derdiger v. Tallman* held that the acquiring corporation was an "affiliate." 75 F. Supp. 2d 322, 325 (D. Del. 1999). Accordingly, because DRS was ESSI's affiliate for purposes of the savings clause and because DRS sought to purchase securities from ESSI's shareholders, the first exception applies. *Id.*

B. The Savings Clause's Second Exception

The class claims against Newman also fall within the savings clause's second exception. *See* SLF486-87. The second exception applies to (1) "any recommendation, position, or other communication with respect to the sale of securities of an issuer" that (2) "is made by or on behalf of the issuer or an affiliate of the issuer to holders of equity

securities of the issuer," and (3) "concerns decisions of such equity holders with respect to voting their securities," among other rights. 15 U.S.C. §78bb(f)(3)(A)(ii)(II).

Here, each of the second exception's requirements is met. First, Newman signed the Registration Statement encouraging the ESSI shareholders to vote in favor of the merger (LF124, 152-53 (¶¶34, 122)), which satisfies the requirement of "communication with respect to the sale." *See Greaves v. McAuley*, 264 F. Supp. 2d 1078, 1083 (N.D. Ga. 2003) (communications "intended to encourage . . . approv[al] [of] the proposed merger agreement" satisfied the requirement); *Derdiger*, 75 F. Supp. 2d at 325 ("proxy statements that were mailed to . . . stockholders during the merger" satisfied the requirement). Second, because the Registration Statement concerned the decision of the ESSI shareholders "with respect to voting their securities," the third requirement is met.

Finally, the second requirement is met. Just like with the first exception, DRS qualifies as an "affiliate," *see Derdiger*, 75 F. Supp. 2d at 325, and therefore the recommendation was "made by . . . an affiliate of the issuer."

More importantly, even if DRS does not qualify as an "affiliate," the second requirement is still satisfied because the recommendation by DRS was made "on behalf of the issuer" – *i.e.*, on behalf of ESSI. As the Ninth Circuit in *Madden v. Cowen & Co.* concluded, the common sense meaning of the phrase "on behalf of" encompasses communications made "in the interest of" or "for the benefit of" the issuer. 576 F.3d 957, 973 (9th Cir. 2009). Here, Newman concedes that he signed the Registration Statement. LF124 (¶34). The Registration Statement was intended to obtain the ESSI shareholders' vote in favor of the Merger. LF136-139 (¶¶57-65). The voter approval

was also necessary so that the ESSI Defendants could receive their personal benefits. *See* LF135, 139-140 (¶¶55, 66-68). Thus, by signing the Registration Statement, Newman made a recommendation "on behalf" of ESSI because he made it "in the interest of" and "for the benefit of" ESSI. *Madden*, 576 F.3d at 973; *see also Occidental Fire & Cas. Co. of N. Carolina v. Soczynski*, No. 11-cv-2412 (JRT/JSM), 2013 WL 101877, at *12 & n.14 (D. Minn. Jan. 8, 2013) ("numerous courts . . . have concluded that 'on behalf of,' when used in various contexts, . . . unambiguously means in the interest of, as a representative of, or for the benefit of" (citing cases)).

Accordingly, SLUSA does not preclude Nickell's claims against Newman.[11]

[11] Newman also briefly mentions his failed motion to dismiss the appeal as to him. The Court of Appeals correctly denied the motion, *see Nickell*, slip op. at 1 n.1, and Newman does not contend before this Court that the appeal should be dismissed.

V. The Court Should Reject Newman's Alternative Ground for Affirmance Because Missouri Law Recognizes a Cause of Action for Aiding and Abetting, That Cause of Action Is Not Limited to Physical Torts, and Nickell's Count II Pleads the Necessary Elements as to Newman

A. The Court Should Not Decide This Issue in the First Instance

Because the Circuit Court dismissed the claims against Newman for failure to state a direct claim or allege the existence of duty, it never reached the merits of the aiding-and-abetting claim. Newman gives no good reason why this Court should decide this question in the first instance. Rather, a remand is appropriate, should the Court reverse on other grounds. *See Prins v. Dir. of Revenue*, 333 S.W.3d 17, 22 (Mo. Ct. App. 2010).

B. If the Court Chooses to Decide the Issue in the First Instance, the Court Should Reject Newman's Arguments

The claim for aiding and abetting another in the commission of a tort is based on §876(b) of the Restatement (Second) of Torts. Missouri courts and the vast majority of courts nationwide that have considered this issue have adopted §876(b). Nonetheless, Newman argues the Court should reject these decisions, buck the national trend, and jettison §876(b) for the so-called "non-physical" torts. But the Court typically follows the Restatement even where it must overrule precedent. Here, no reason exists to depart from the Restatement because §876(b) is fully consistent with Missouri tort law.

1. Missouri Law Clearly Recognizes a Cause of Action for Aiding and Abetting the Commission of a Tort

The Court of Appeals adopted §876(b) in *Shelter Mutual Insurance Co. v. White*, 930 S.W.2d 1 (Mo. Ct. App. 1996). The court rejected arguments that "Missouri courts have not recognized a tort based upon §876." *Id*. at 3. The court noted that this Court had previously cited §876 "with apparent favor" before ultimately concluding the section did not apply in the case before it. *Id*. at 3-4 (discussing *Zafft v. Eli Lilly & Co*., 676 S.W.2d 241, 245 (Mo. 1984)). *Shelter* also cited extensive cases from around the country upholding §876(b) claims. *Id*. at 3 & n.4.

Other Missouri courts have also recognized a claim for aiding and abetting the commission of a tort. *See Safe Auto Ins. Co. v. Hazelwood*, 404 S.W.3d 360, 367 (Mo. Ct. App. 2013) (recognizing that the claim exists under Missouri law, but dismissing on the merits); *Phelps v. Bross*, 73 S.W.3d 651, 656-57 (Mo. Ct. App. 2002) (implicitly recognizing the existence of aiding-and-abetting liability in the commission of a battery); *Brown v. Barr*, 171 S.W. 4, 6 (Mo. Ct. App. 1914) ("The rule is well settled that one who is present, aiding, and abetting another who commits an assault, is as much a principal as he who strikes the blow or fires the shot." (citing cases)).[12]

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[12] Indeed, nearly 150 years ago, the Court observed that "[t]he law is well laid down that any person who is present at the commission of a trespass, encouraging or exciting the same by words, gestures, looks, or signs, or who in any way or by any means countenances or approves the same, is in law deemed to be an aider and abettor, and

Federal courts applying Missouri law are in accord. *See, e.g.*, *Callaway Bank v. Bank of the W.*, No. 12-4159-cv-C-MJW, 2013 WL 1222781, at *2 (W.D. Mo. Mar. 25, 2013); *Lonergan v. Bank of Am., N.A.*, No. 12-cv-4226-NKL, 2013 WL 176024, at **11-12 (W.D. Mo. Jan. 16, 2013); *Phelps v. deMello*, No. 07cv366 CDP, 2007 WL 1063567, at *2 (E.D. Mo. Apr. 9, 2007); *see also Terrydale Liquidating Trust v. Barness*, 611 F. Supp. 1006, 1015-16 (S.D.N.Y. 1984) (Missouri courts would adopt civil aider-and-abettor liability for breaches of fiduciary duties).

Arguing the contrary, Newman relies on *Bradley v. Ray*, 904 S.W.2d 302 (Mo. Ct. App. 1995). Such reliance is misplaced for three reasons. First, *Bradley* predates *Shelter*. Second, it contains very little analysis of §876(b). Third, as the Circuit Court correctly recognized, *Bradley* does not "directly accept[] or reject[]" the use of §876. *See* LF49. Rather, in *Bradley*, the court ultimately dismissed the aiding-and-abetting claim for failure to plead facts that would support such a claim. 904 S.W.2d at 315.[13]

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liable as a principal." *McMannus v. Lee*, 43 Mo. 206, 208 (1869); *see also Page v. Freeman*, 19 Mo. 421, 422 (1854) (under "the common law," one "who counselled, aided or assisted in any way the commission of the wrong, was, in the eye of the law, as much a principal as he who actually inflicted the blows"); *Cooper v. Johnson*, 81 Mo. 483, 488-89 (1884); *Cooper v. Mass. Bonding & Ins. Co.*, 186 S.W.2d 549, 551 (Mo. Ct. App. 1944); *accord, e.g.*, *Curlee v. Donaldson*, 233 S.W.2d 746, 753-54 (Mo. Ct. App. 1950).

[13] This Court has previously rejected the suggestion that just because prior cases have declined to adopt a provision of the Restatement, where the adoption would not

Similarly misplaced is Newman's attempt to limit *Shelter* to drunk-driving cases or so-called "physical" torts. In support of this limitation, Newman relies on *Joseph*, 967 S.W.2d at 624. But *Joseph* expressly declined to adopt such limitation, holding instead that §876(b) could not apply under the facts of that case. *Id.* at 630. Indeed, as the Court of Appeals in this case recognized, there is no valid reason to limit *Shelter* to the so-called "physical" torts. *Nickell*, slip op. at 13; *see also Lonergan*, 2013 WL 176024 at *12 (finding "no principled reason why aiding and abetting would exist for [trespass, assault, or battery], but not for at least other intentional torts, like fraud and misrepresentation").

2. The Court Usually Follows the Restatement Even Where (Unlike Here) It Must Overrule Precedent to Do So

When confronting previously-unsettled issues of tort law, the Court often adopts the Restatement. *See, e.g.*, *Sides v. St. Anthony's Med. Ctr.*, 258 S.W.3d 811, 813 (Mo. banc 2008) ("adopt[ing] the position set out in Restatement (Second) of Torts Section 328D, comment d" regarding *res ipsa loquitor* theory); *Harris v. Niehaus*, 857 S.W.2d 222, 226 (Mo. banc 1993) ("We adopt §§343 and 343A(1) as accurate statements of the law of Missouri" regarding duties owed by possessors of land); *Giberson v. Ford Motor Co.*, 504 S.W.2d 8, 9 (Mo. 1974) (quoting the Court's decision "adopt[ing] the rule of strict liability in tort stated in 2 Restatement, Law of Torts, Second, §402A").

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have made a difference, that it means those cases have *sub silencio* rejected the theory. *See Humphrey v. Glenn*, 167 S.W.3d 680, 683-84 (Mo. banc 2005).

The Court has followed the Restatement even if it had to overrule an "entrenched rule presently in force in Missouri." *See Bass v. Nooney Co.*, 646 S.W.2d 765, 768 (Mo. 1983). For example, in *Sides*, the Court adopted the Restatement's provision regarding *res ipsa loquitur* theory to narrow its own precedent and to overrule several court-of-appeals decisions. 258 S.W.3d at 813. The Court explained that "[t]his Court did not have the benefit of the Restatement position at the time of" its prior decision, that since then "[t]he vast majority of courts and commentators ha[d] adopted the [Restatement] approach," and that it found "the reasoning of section 328D of the Restatement and the cases following it to be persuasive." *Id*. at 816, 819 ("join[ing] with the 28 out of 36 other jurisdictions that ha[d]" adopted §328D); *see also Humphrey*, 167 S.W.3d at 683-85 (adopting Restatement (Second) of Torts §335 regarding landowners' duties to trespassers despite prior opinions stating that Missouri had not adopted that provision).

3. Most Other Courts Considering §876(b) Have Adopted It

"The majority of jurisdictions that have addressed the validity of a claim for aiding and abetting under §876(b) have held that such a claim exists." *Dale v. Ala Acquisitions, Inc.*, 203 F. Supp. 2d 694, 700 (S.D. Miss. 2002) (citing cases); *see also Miles Farm Supply, LLC v. Helena Chem. Co*., 595 F.3d 663, 666 (6th Cir. 2010) (observing that Kentucky "recognizes a claim for aiding and abetting tortious conduct, which covers fiduciary-breach claims" and noting that "it, like the majority of jurisdictions, follows the Restatement [§876(b)] in defining the claim"); *Farm Bureau Life Ins. Co. v. Am. Nat'l Ins. Co*., 505 F. Supp. 2d 1178, 1189 (D. Utah 2007) (observing that a claim for aiding

and abetting the breach of a fiduciary duty received "substantial support from other jurisdictions and the Restatement" and finding such support to be "persuasive").

Notably, a 2006 survey listed some thirty jurisdictions allowing §876(b) claims, with only a few cases rejecting or expressing doubt regarding recognition of such claims. *See* Richard C. Mason, *Civil Liability for Aiding and Abetting*, 61 BUS. LAW 1135, 1139-40 & nn.23-24, nn.159-161 (May 2006) (citing cases). More importantly, the survey noted that at least eighteen states have specifically "recognized a cause of action for aiding and abetting breach of fiduciary duty." *Id.* (collecting cases).[14]

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[14] *See also In re Senior Cottages of Am., LLC,* 482 F.3d 997, 1007 (8th Cir. 2007) (Minnesota law recognizes a claim for aiding and abetting a breach of fiduciary duty and upholding claim); *Holmes v. Young*, 885 P.2d 305, 309 (Colo. Ct. App. 1994) (recognizing tort of aiding and abetting a breach of fiduciary duty); *Dale*, 203 F. Supp. 2d at 700 (observing that "Tennessee has adopted the Restatement of Torts §876(b) theory of aiding and abetting" and predicting "that such a claim is [also] viable under Mississippi law"); *Stanton v. Bank of Am., N.A.*, 834 F. Supp. 2d 1061, 1087-88 (D. Haw. 2011) (upholding claim under Hawaii law); *Laufen Int'l, Inc. v. Larry J. Lint Floor & Wall Covering, Co.*, No. 10-cv-0199, 2010 WL 1714032, at *5 (W.D. Pa. Apr. 27, 2010) (upholding claim for aiding and abetting a breach of a fiduciary duty of a non-physical tort); *Woloshen v. State Farm Lloyds*, No. 08-cv-0634-D, 2008 WL 4133386, at *3 (N.D. Tex. Sept. 2, 2008) (same); *N. Valley Commc'ns, LLC v. MCI Commc'ns Servs., Inc.*, No. CIV. 07-1016, 2008 WL 2627519, at *8 (D.S.D. June 26, 2008) (same).

Arguing the contrary, Newman cites only two jurisdictions (Ohio and Alabama) that have declined to recognize the tort of aiding and abetting a breach of fiduciary duty. *See* Newman's Br. at 43-44. But these jurisdictions are outside the mainstream when it comes to civil liability under §876(b) – which has generally gained "nationwide acceptance," and the "trend [is] toward increased recognition" of such claims. *See* Mason, 61 BUS. LAW at 1139-40. Indeed, Ohio appears to have recognized such claims until the Supreme Court of Ohio summarily reversed course without explanation. *See DeVries Dairy, LLC v. White Eagle Coop. Ass'n, Inc.*, 974 N.E. 2d 1194, 1195 (Ohio 2012) (Pfeifer, J., dissenting) (observing that "it seems clear that Ohio does recognize a cause of action for tortious acts in concert" and citing §876(b)).

4. Section 876(b) Imposes Liability if the Defendant Knew that a Third Party Owes a Duty to the Plaintiff

Under §876(b), "the defendant need not owe a duty to the plaintiff, but rather, must know that a third party owes a duty to the plaintiff." *Lawyers Title Ins. Corp. v. United Am. Bank*, 21 F. Supp. 2d 785, 795-96 (W.D. Tenn. 1998). The cause of action "does not impose liability for aiding and abetting based on a duty between the defendant and plaintiff," rather, liability is found if "the defendant knew that his companions' conduct constituted a breach of duty." *Id*. (analyzing Tennessee law).

Numerous other courts are in accord. *See, e.g.*, *GCM, Inc. v. Ky. Cent. Life Ins. Co.*, 947 P.2d 143, 147-48 (N.M. 1997) ("An injured party need not have a direct relationship with the third party against whom liability is sought as an aider and abettor. Rather the injured party must have a fiduciary relationship with the principal tortfeasor,

and the third party must occupy the role of an accomplice in relation to the principal tortfeasor." (citing cases)); *Laufen Int'l*, 2010 WL 1714032, at *5; *Williams v. Bank Leumi Trust Co.*, No. 96 Civ. 6695 (LMM), 1997 WL 289865, at *5 & n.3 (S.D.N.Y. May 30, 1997) (considering a claim for aiding and abetting breach of fiduciary duty against a defendant who owed no fiduciary duty).

5. There Is No Good Reason to Reject §876(b) in This Case

Sound policies encourage victims to seek redress from those who knowingly offer substantial assistance to other wrongdoers in causing injury. Indeed, aiding and abetting liability is "uniquely suited to address wrongdoing that occurs in transactional matrices that as of [lately] frequently are of breathtaking complexity." Mason, 61 BUS. LAW. at 1135. Because there is no principled basis for parsing so-called "non-physical torts" from "physical" torts, courts routinely allow claims for aiding and abetting a breach of fiduciary duty for non-physical torts. *See, e.g., In re Rural Metro Corp. Stockholders Litig.*, C.A. No. 650-VCL, --- A.3d ---, 2014 WL 1053140, at **33-34 (Del. Ch. Mar. 7, 2014) (financial advisor liable for aiding and abetting breaches of fiduciary duties by the company's board in connection with the company's 2011 sale).

6. Nickell Adequately States a Claim Against Newman

The SAP alleges sufficient facts to state a claim for aiding and abetting against Newman. In *Shelter*, the court of appeals expressly adopted the elements of the aiding-and-abetting claim set forth in §876(b):

> "For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he . . . knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself . . . ."

930 S.W.2d at 3 (quoting RESTATEMENT (SECOND) OF TORTS §876 (1979)).

The SAP satisfies the test under §876(b) because Newman "was aware of the ESSI Defendants' backdating scheme" and helped the ESSI Defendants conceal that scheme by affirmatively "caus[ing] DRS to assume all liability for the illegal stock options backdating activity at ESSI – in exchange for which Newman agreed with the ESSI Defendants to pay a purchase price substantially less than DRS was otherwise willing to pay to acquire ESSI." LF123 (¶31); *see also* LF141-142 (¶¶74-75). This misconduct constitutes "substantial assistance or encouragement" for the ESSI Defendants' scheme, seeing as the entire ESSI–DRS merger was consummated for the purposes of concealing the stock-options backdating. *See, e.g.*, LF133-135 (¶¶51-55).

In light of the foregoing affirmative steps, Newman's suggestion that he merely acquiesced in the ESSI Defendants' misconduct rings hollow. In any event, at this stage, the Court must accept Nickell's allegations as true. *See Lynch*, 260 S.W.3d at 836.

Accordingly, Nickell has sufficiently stated a claim for aiding and abetting breach of fiduciary duty. *See Shelter*, 930 S.W.2d at 3.

CONCLUSION

The Court should adopt in full the reasoning of the Court of Appeals and, consistent with that opinion, reverse and remand the dismissal of counts I, II, and III.

Dated: April 21, 2014

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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 7,739 words contained in this brief.

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