In the Missouri Court of Appeals
Eastern District
DIVISION ONE

DANIEL B. NICKELL,	)	No. ED99163
	)	
Appellant,	)	Appeal from the Circuit Court
	)	of the City of St. Louis
vs.	)	0822-CC09449-01
	)	
MICHAEL F. SHANAHAN, SR., et al.,	)	Honorable Joan L. Moriarty
	)	
Respondents.	)	Filed: June 4, 2013

OPINION

Daniel B. Nickell appeals the judgment dismissing Counts I-III of his second amended petition against Michael F. Shanahan, Sr., Michael F. Shanahan, Jr., David Mattern, Thomas J. Guilfoil, Kenneth E. Lewi, Crosbie E. Saint, Earl W. Wims, Gary C. Gerhardt, Gerald A. Potthoff, Steven L. Landmann, and Mark S. Newman ("Respondents") seeking to recover damages resulting from the merger between Engineered Support Systems, Inc. ("ESSI") and DRS Technologies, Inc. ("DRS"). Because Nickell's second amended petition sets forth a set of facts that, if proven, would entitle Nickell to relief, we reverse and remand.[1]

I. BACKGROUND

A. Parties

ESSI, a Missouri corporation, merged with DRS in January 2006. At all relevant times,

[1] Newman's motion to dismiss the appeal, taken with the case, is denied.

Shanahan Sr., Shanahan Jr., Mattern, Gerhardt, Potthoff, and Landmann were directors and officers of ESSI, Guilfoil, Lewi, Saint, and Wims were directors, but not officers, of ESSI,[2] and Newman was the CEO and Chairman of DRS. Nickell, allegedly a stockholder of ESSI who sold his stock in connection with the merger, brought a purported class action on behalf of all similarly situated shareholders of ESSI who sold stock in connection with the merger, seeking to recover damages resulting from the sale of their ESSI stock.

B. Procedural History

After filing an original petition against Respondents, Nickell was granted leave to file a an amended petition, adding ESSI's auditor, PricewaterhouseCoopers LLP ("PWC"), as a defendant. PWC removed the action to the United States District Court for the Eastern District of Missouri based on federal question jurisdiction on the ground that Nickell's action was precluded by the federal Securities Litigation Uniform Standards Act ("SLUSA"), 15 U.S.C. section 78bb (1998). The District Court found that the action could properly be maintained in state court and remanded the cause back to the trial court. *Nickell v. Shanahan*, 2010 WL 199957 (E.D. Mo.).

On remand, the ESSI Defendants and PWC moved to dismiss Nickell's claims in the first amended petition, arguing, among other things, 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. The trial court (Judge Robert H. Dierker) declined to revisit the ruling of the District Court on the issue of SLUSA preclusion and found that Nickell had standing to bring his claims individually where Nickell alleged "that his individual rights were violated by Defendants' conduct resulting in an agreement to merge ESSI

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

in exchange for a reduced share price for ESSI stock at the time of the merger." Ultimately, the trial court granted the motions in part, denied the motions in part, and granted Nickell leave to amend the first amended petition. Thereafter, Nickell filed his second amended petition, and the cause was reassigned to Judge Joan L. Moriarty.

C. Allegations in the Second Amended Petition

The allegations in Nickell's second amended petition are 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. 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.[3] 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. As a result, on September 21, 2005, ESSI and DRS entered into an agreement whereby DRS would acquire ESSI. Newman, aware of the ESSI Defendants' improper backdating scheme, agreed that DRS would assume any corresponding

[3] Judge Gary Lynch's dissent in *New England Carpenters Pension Fund v. Haffner* is helpful in understanding the practice of "backdating" stock options:

> 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.

391 S.W.3d 453, 463 (Mo. App. S.D. 2012) (Lynch, J., dissenting) (internal quotation omitted). "Backdating" occurs when the grant date of a stock option precedes the date the decision is made to award the stock option. *Id*. 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. *Id*.

liability. 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.[4] 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. The concealment of the ESSI Defendants' conduct induced Nickell and the purported class to vote to approve the merger and sell their ESSI stock at a reduced price.

Nickell's second amended petition alleges four counts in relation to the above allegations. 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

[4] The petition also alleges that Shanahan Sr. received an additional $5 million payoff "as compensation for Mr. Shanahan's consulting services in connection with the exploration of a possible sale of ESSI."

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[5] as a result of the defendants' alleged recommendations to ESSI shareholders to approve ESSI's merger with DRS.

D. Dismissal of the Second Amended Petition

Respondents filed motions to dismiss the second amended petition. The trial court (Judge Moriarty) dismissed Counts I and III, finding that Nickell failed to state a claim upon which relief can be granted because the second amended petition only set forth derivative claims and failed to allege any facts giving him standing to individually sue the ESSI Defendants. As an alternative basis for dismissing Count I, the trial court found that Nickell failed to state a claim upon which relief can be granted because he failed to allege the necessary element of duty. Specifically, the trial court found that officers and directors of corporations only owe fiduciary duties to the corporation and the shareholders collectively, not to individual shareholders. Because Count II, for aiding and abetting a breach of fiduciary duties, was based on Count I and Count I was dismissed for a failure to state a claim upon which relief can be granted, the trial court also dismissed Count II. The trial court dismissed Count IV only as to Newman, and Nickell voluntarily dismissed Count IV against the remaining Defendants. Nickell appeals the trial court's dismissal of Counts I-III of his second amended petition.

II. DISCUSSION

Nickell asserts three points on appeal, challenging the trial court's dismissal of Counts I-III of his second amended petition.

[5] In addition to Respondents, PWC was joined as a defendant in Count IV. Nickell does not appeal the dismissal of Count IV, and PWC is not a party to this appeal.

A. Standard of Review

A trial court's grant of a motion to dismiss is reviewed de novo. *Stabler v. Stabler*, 326 S.W.3d 561, 564 (Mo. App. E.D. 2010). We treat the facts contained in the petition as true and construe them liberally in favor of the plaintiff. *Id*. "If the petition sets forth any set of facts that, if proven, would entitle the plaintiff to relief, then the petition states a claim." *Id*. (internal quotation omitted).

B. Nickell has Standing to Bring Individual Claims

In his first point on appeal, Nickell claims that the trial court erred in dismissing Counts I-III on the ground that the second amended petition set forth derivative claims for which he had no standing to maintain an individual action. Nickell contends that the second amended petition sets forth individual claims by alleging that Nickell and the purported class suffered an injury independent from any injury suffered by ESSI. We agree.

It is a well-established rule of corporate law that shareholders must normally bring a derivative action[6] in order to file suit against an officer or director. *Centerre Bank of Kansas City, Nat. Ass'n v. Angle*, 976 S.W.2d 608, 613 (Mo. App. W.D. 1998). "Generally, corporate shareholders cannot in their own right and for their own personal benefit maintain an action for the recovery of corporate funds or property improperly diverted or appropriated by the corporation's officers and directors." *Place v. P.M. Place Stores Co.*, 950 S.W.2d 862, 865 (Mo. App. W.D. 1996). The right to maintain such an action is the right of the corporation, i.e., the shareholders collectively, who sustained the injury. *Id*. Therefore, suits for wrongs to the corporation must be brought derivatively, on behalf of the corporation. *Centerre Bank*, 976 S.W.2d at 613. This rule exists to avoid a multiplicity of suits and disproportionate recoveries

[6] "[A] derivative action is in legal effect a suit by the corporation conducted by the shareholders as the corporation's representative." *Goldstein v. Studley*, 452 S.W.2d 75, 78 (Mo. 1970).

because, since the wrong is against the corporation, a judgment in favor of individual shareholders would not bar actions brought by other shareholders or creditors for the same wrong to the corporation. *Id.*

However, under certain circumstances, a shareholder may have standing to maintain an action in his or her own right where the shareholder asserts a violation of rights individual to them. *Id.* 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.* For example, shareholders have been allowed to bring an individual action for claims alleging that they were personally denied the right to inspect corporate books and records. *Dawson v. Dawson*, 645 S.W.2d 120, 125-26 (Mo. App. W.D. 1982). Similarly, claims by shareholders asserting that they were deprived from their position as controlling shareholders have been found to be actions that must be maintained individually. *Place*, 950 S.W.2d at 865-66.

In *Gieselmann v. Stegeman*, the Missouri Supreme Court looked to the crux of the pleading and found that an alleged injury was individual to the stockholder where the complaining stockholder pursued a claim alleging that he was fraudulently deprived of his shares of stock by the defendants. 443 S.W.2d 127, 131 (Mo. 1969). "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." *Id.* The Court explained that the outstanding stock of the corporation constituted the individual property of the stockholder, and it was "not necessary for the [stockholder] to sue in behalf of the corporation" for redress of harm to his stock that affected him directly and individually. *Id.*

Similar to the allegations of the complaining stockholder in *Gieselmann*, the second amended petition sets forth allegations of a direct fraud committed upon Nickell and the purported class. 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 purported class to approve DRS' acquisition of ESSI and sell their individual shares in connection with the acquisition. These allegations affect rights personal to the shareholders for which an individual action may be maintained. *See id*. (stating that the "outstanding stock of a corporation is the individual property of the shareholders" and "the corporation . . . has no interest in it or in dealings among shareholders with respect to their stock"); *see also* 12B Fletcher Cyclopedia of the Law of Private Corporations section 5915 (2000) (actions relating to a shareholder's right to vote and actions alleging deceptive or misleading proxy solicitations may be brought individually). More importantly, the alleged injury constitutes a harm individual to Nickell and the purported class, distinct from any injury to the corporation, because the alleged injury was a reduced price received for their individual shares. *See 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").

Because 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. Accordingly, the trial court erred in dismissing Counts I-III of Nickell's second amended petition for failure to state a claim upon which relief can be granted on the ground that Nickell's petition set forth derivative claims. Point one is granted.

C. Nickell's Petition Alleges that the ESSI Defendants Owe Nickell and the Purported Class Fiduciary Duties

In his third and final point on appeal,[7] Nickell claims that the trial court erred in dismissing Count I of the second amended petition on the ground that Nickell failed to allege the necessary element of duty. We agree.

As an alternative basis for dismissing Count I of Nickell's second amended petition, the trial court found that Nickell failed to allege that the ESSI Defendants owed Nickell and the purported class a fiduciary duty because corporate officers and directors only owe fiduciary duties to the corporation and shareholders collectively, not to individual shareholders.

To properly plead a claim for a breach of a fiduciary relationship, a plaintiff must allege: (1) the existence of a fiduciary duty; (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. App. W.D. 2000). The fiduciary relationship between a director or officer of a corporation and the shareholders is generally held to be between the directors or officers and the shareholders as a whole. *Centerre Bank*, 976 S.W.2d at 613. However, that relationship will extend to the shareholders individually if the directors or officers violated rights individual to the shareholders that injured the shareholders directly. *Id*. at 614; *Dawson*, 645 S.W.2d at 125.

For the reasons set forth under section II.B. above, the second amended petition alleges that the ESSI Defendants' breaches of fiduciary duties violated rights individual to Nickell and the purported 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 purported class individually. Therefore, the trial court erred in dismissing Count I of the

[7] Nickell's second point on appeal asserts an alternative basis for finding that he has standing to assert his claims individually. Because we have already held, under the analysis of Nickell's first point on appeal, that Nickell had standing to pursue his claims individually, we need not address Nickell's second point on appeal.

second amended petition for failure to state a claim upon which relief can be granted on the ground that Nickell failed to allege the element of duty. Point three is granted.

D. Newman's Alternative Arguments in Support of Affirming the Dismissal of Count II

As previously indicated, the sole count brought by Nickell against Newman is under Count II for aiding and abetting the ESSI Defendants' breaches of fiduciary duties. The trial court dismissed the count finding that, because Count I was dismissed for a failure to state a claim upon which relief can be granted and Count II was based on Count I, Count II must also be dismissed for failure to state a claim upon which relief can be granted. Newman argues that even if we find the dismissal of Count I to be erroneous, as we did under our discussion of points one and three above, the dismissal of Count II of the second amended petition should nevertheless be affirmed for two additional reasons: (1) the trial court lacked subject matter jurisdiction under SLUSA to bring claims against Newman; and (2) Missouri does not recognize a cause of action for aiding and abetting a breach of fiduciary duties.

1. SLUSA Preclusion

Newman first claims that the dismissal of Count II should be affirmed because Nickell's claims against Newman are precluded by SLUSA. Newman argues that SLUSA precludes Nickell's claims against Newman because the second amended petition is a putative class action brought under Missouri law that alleges Newman misrepresented or omitted a material fact in connection with the purchase or sale of a covered security. We disagree.

SLUSA "expressly preempts all state law class actions based upon alleged untrue statements or omissions of a material fact, or use of a manipulative or deceptive device or contrivance, in connection with the purchase or sale of a covered security." *Sofonia v. Principal Life Ins. Co.*, 465 F.3d 873, 876 (8th Cir. 2006) (internal quotation omitted); *see also* 15 U.S.C.

section 78bb(f)(1)-(2) (1998). However, under SLUSA's savings clause, commonly known as the "Delaware carve-out," a covered class action that is based upon the law of the state in which the issuer of the securities is incorporated[8] may be maintained in a state court if the class action involves either:

> (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. section 78bb(f)(3)(A)(i)-(ii).

Here, Nickell's allegations in his second amended petition clearly meet the second Delaware carve-out under 15 U.S.C. section 78bb(f)(3)(A)(ii)(II). In order for the second amended petition to survive under the second Delaware carve-out, it must contain allegations that: (1) there was a recommendation, position, or other communication made with respect to the sale of ESSI shares; (2) the recommendation, position, or other communication was made by or on behalf of ESSI or an affiliate of ESSI to ESSI shareholders; and (3) the recommendation, position, or other communication concerned decisions of ESSI shareholders with respect to voting their shares, acting in response to a tender or exchange offer, or exercising dissenters' or appraisal rights. *See id.* The first and third requirements are met because the second amended petition alleges that Newman signed a registration statement that recommended to ESSI shareholders that they should vote to approve the merger between ESSI and DRS and sell their ESSI stock in exchange with the merger. The second requirement is also met because the second

[8] There is no dispute that Nickell's second amended petition constitutes a "covered class action" under SLUSA that is based on Missouri law, the state in which the issuer, ESSI, was incorporated.

amended petition alleges Newman, as the CEO and Chairman of DRS, issued a statement on behalf of DRS, and DRS, as a merging corporation with ESSI, is considered an affiliate of ESSI for the purposes of 15 U.S.C. section 78bb(f)(3)(A). *Nickell*, 2010 WL 199957 at *4 (citing *Derdiger v. Tallman*, 75 F.Supp. 2d 322, 325 (D. Del. 1999). Moreover, even if DRS was not an affiliate of ESSI, the second amended petition contains allegations that Newman made the recommendations on behalf of ESSI. Under 15 U.S.C. section 78bb(f)(3)(A)(ii)(II)(aa), the phrase "on behalf of" contemplates communications made "in the interest of" or "for the benefit of" the issuer. *Madden v. Cowen & Co.*, 576 F.3d 957, 973 (9th Cir. 2009). By allegedly signing the registration statement, Newman made a recommendation "in the interest of" and "for the benefit of" ESSI. Accordingly, SLUSA does not preclude Nickell's claims against Newman.

2. Aiding and Abetting a Breach of Fiduciary Duties

Newman also argues that the dismissal of Count II, alleging he aided and abetted the ESSI Defendants' breaches of fiduciary duties, should be affirmed because Missouri does not recognize a cause of action for aiding and abetting a breach of fiduciary duties. We disagree.

The tort for aiding and abetting another in the commission of a tort is based on the Restatement (Second) of Torts section 876(b) (1979). *Bradley v. Ray*, 904 S.W.2d 302, 315 (Mo. App. W.D. 1995) (acknowledging that the tort of aiding and abetting is based on section 876(b) without deciding whether Missouri recognizes a cause of action for the tort). That provision states:

> 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.

Restatement (Second) of Torts section 876(b) (1979). This provision has been expressly recognized as a cause of action in Missouri. *Shelter Mut. Ins. Co. v. White*, 930 S.W.2d 1, 3-4

(Mo. App. W.D. 1996). The *Shelter* Court recognized the plaintiffs' claim for aiding and abetting negligence under section 876(b) against passengers in a car who actively encouraged an intoxicated driver to drive fast and disobey traffic signs. *Id*. at 5.

Nevertheless, Newman argues that the recognition of the tort in Missouri should not be expanded beyond physical torts to allow liability for aiding and abetting a breach of fiduciary duties. In expressly adopting section 876(b) as a tort in Missouri, the *Shelter* Court did not base its decision on, or otherwise limit the application of the tort to, the circumstances of that case. *See id*. at 3-5. Moreover, the Southern District recently reaffirmed *Shelter*'s adoption of the tort under section 876 without stating any limitations to the tort's application. *Safe Auto Ins. Co. v. Hazelwood*, 2013 WL 454886 at *5 (Mo. App. S.D.) (analyzing a plaintiff's claim for aiding and abetting negligence). We see no reason why the recognized tort for aiding and abetting should apply exclusively to claims alleging a defendant aided and abetted an underlying physical tort such as negligence, assault, or battery, but not apply when the underlying tort that is being aided and abetted is a breach of fiduciary duties. *See Lonergan v. Bank of America, N.A.*, 2013 WL 176024 at *12 (W.D. Mo.) (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"). Accordingly, we hold that a claim for aiding and abetting a breach of fiduciary duties is a recognized cause of action.

Here, Nickell's petition contains allegations that Newman had knowledge of the ESSI Defendants' misconduct and actively assisted the ESSI Defendants in breaching their fiduciary duties to Nickell and the purported class by concealing the ESSI Defendants' misconduct through the dissemination of a false and misleading registration statement and prospectuses that induced Nickell and the purported class to sell their shares for a reduced price. These allegations,

liberally construed under the applicable standard of review, properly plead that Newman had knowledge that the ESSI Defendants' alleged misconduct constituted breaches of fiduciary duties and that Newman gave substantial assistance or encouragement to the ESSI Defendants in breaching those duties. Whether Newman actually had knowledge of the ESSI Defendants' alleged breaches and whether his actions rose to the level of substantial assistance or encouragement in breaching those duties are questions left for determination by the trier of fact. Accordingly, Count II of Nickell's second amended petition states a claim upon which relief can be granted.

3. Conclusion

Count II of Nickell's second amended petition is not precluded under SLUSA and sets forth a claim upon which relief can be granted for aiding and abetting breaches of fiduciary duties. Accordingly, Newman's alternative grounds for affirming the trial court's dismissal of Count II of the second amended petition are without merit.

III. CONCLUSION

The trial court's judgment dismissing Counts I-III of the second amended petition is reversed and the cause is remanded for further proceedings in accordance with this opinion.

GLENN A. NORTON, J.

Clifford H. Ahrens, P.J. and
Sherri B. Sullivan, J., concur