No. 12-1208

IN THE

Supreme Court of the United States

UBS FINANCIAL SERVICES INCORPORATED OF PUERTO RICO, *et al.*,

Petitioners,

v.

UNIÓN DE EMPLEADOS DE MUELLES DE PUERTO RICO PRSSA WELFARE PLAN, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF IN OPPOSITION

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COUNTER-STATEMENT OF QUESTION PRESENTED

Whether the United States Court of Appeals for the First Circuit appropriately applied a *de novo* standard of review to the District Court's dismissal of this derivative action for failure to plead demand futility pursuant to Federal Rule of Civil Procedure 23.1?

RULE 29.6 STATEMENT

Plaintiffs-Appellants Unión de Empleados de Muelles de Puerto Rico PRSSA Welfare Plan and Unión de Empleados de Muelles de Puerto Rico AP Welfare Plan are welfare plans, have no parent corporations, and do not issue shares of stock to the public.

TABLE OF CONTENTS

Table of Contents

TABLE OF CITED AUTHORITIES

Page

CASES

Cited Authorities

Cited Authorities

Cited Authorities

CONSTITUTION, STATUTES AND RULES

OTHER AUTHORITIES

INTRODUCTION

The Petition in this case does not raise a question warranting this Court's review. The First Circuit's *de novo* review of the District Court's dismissal of this derivative action for failure to allege demand futility pursuant to Rule 23.1 is in line with the current trend toward *de novo* review of the legal issue of whether a complaint adequately alleges demand futility, and raises no questions of national significance. It is a stretch to claim, as Petitioners in essence have, that the First Circuit's decision is an outlier. The Eighth Circuit, in a decision issued prior to the filing of the Petition, applied the same *de novo* standard as the First Circuit. Some circuits have not yet addressed the issue. And, while other circuits have applied a nominal abuse of discretion standard, most of those same circuits have applied *de novo* review where the challenge is to the district court's choice and interpretation of legal matters.[1] Moreover, multiple circuits identified by Petitioners as creating the "split in authority" have recently questioned their own precedent and appear to be moving toward adoption of a *de novo* standard in light of the adoption of that standard by the Delaware Supreme Court, the nation's leading state appellate court on corporate law matters.[2] The circuits should be permitted time to reach

1. *See Stein v. Immelt*, 472 F. App'x 64, 65 (2d Cir. 2012); *Halebian v. Berv*, 590 F.3d 195, 203 (2d Cir. 2009); *Cadle v. Hicks*, 272 F. App'x 676, 677 (10th Cir. 2008); *Fagin v. Gilmartin*, 432 F.3d 276, 281 (3d Cir. 2005); *Scalisi v. Fund Asset Mgmt., L.P.*, 380 F.3d 133, 137 (2d Cir. 2004); *Abbott Labs. Deriv. S'holders Litig.*, 325 F.3d 795, 803 (7th Cir. 2001); *Blasband v. Rales*, 971 F.2d 1034, 1040 (3d Cir. 1992).

2. *See Brehm v. Eisner*, 746 A.2d 244, 253-54 (Del. 2000).

unanimity as to a modern standard of review. Thus, this Court's traditional standards for the exercise of certiorari lead to the conclusion that this Court's review is not warranted; there is no compelling reason for the Court to grant the requested writ for certiorari. *See* Sup. Ct. R. 10.

COUNTER-STATEMENT OF THE CASE

A. The Parties

Respondents Unión de Empleados de Muelles de Puerto Rico PRSSA Welfare Plan and Unión de Empleados de Muelles de Puerto Rico AP Welfare Plan (hereafter "Respondents" or "Plaintiffs") are welfare plans designed to provide retirement benefits and severance pay for their member employees. Pet. App. at 75a. At the time the Complaint was filed, and through the briefing of this matter in the First Circuit, Respondents owned shares in four closed-end funds: Puerto Rico Fixed Income Fund II, Inc. ("Fund II"), Puerto Rico Fixed Income Fund III, Inc. ("Fund III"), Puerto Rico Fixed Income IV, Inc. ("Fund IV"), and Tax-Free Puerto Rico Fund II, Inc. ("Tax Free Fund II," and together with Funds II-IV, "the Funds"). *See id.*

Petitioners UBS Financial Services Incorporated of Puerto Rico ("UBS Financial") and UBS Trust Company of Puerto Rico ("UBS Trust," and together with UBS Financial, the "UBS Defendants") are affiliated with UBS AG. *Id.* at 69a. UBS Trust serves as the investment adviser and administrator for the Funds. *Id.* at 70a, 76a-77a, 125a. Operating on all sides of mutual fund and bond transactions – as investment advisor, bond underwriter, and mutual fund manager – the UBS

Defendants manipulated the Funds and the bond market to the detriment of the Funds and its investors, including the Plaintiffs. *Id.* at 69a.

At the time Respondents filed this action, the Funds' affairs were each managed by identically comprised eleven member boards of directors (hereafter referred to collectively as "the Board" and the members thereof as the "Director Defendants") (the UBS Defendants and the Director Defendants are collectively referred to herein as "Petitioners" or "Defendants"). *Id.* at 77a-81a. Four of the Board's members were, at the time this suit was filed, full time employees of UBS: Miguel A. Ferrer, Carlos V. Ubiñas ("Ubiñas"), Stephen C. Roussin ("Roussin"), and Leslie Highley, Jr. *Id.* at 77a-78a.

Three additional Director Defendants, Mario S. Belaval ("Belaval"), Vicente J. León ("León") and Carlos Nido ("Nido"), were managers of large Puerto Rican business concerns that historically have depended, and will likely continue to depend, on capital raised with UBS involvement in Puerto Rico's local markets. *See id.* at 78a-80a. In addition to the Funds, Belaval has also served as director of numerous other UBS-affiliated funds, including UBS's IRA Select Growth and Income Fund. For the fiscal year ending July 31, 2009, Belaval's aggregate compensation for service on the boards of funds advised or co-advised by UBS Trust was reported to be $137,531. *Id.* at 78a.

Similarly, in addition to the Funds, León also sat on the board of several other UBS-affiliated funds, including the Tax-Free Puerto Rico Fund, Target Maturity Fund, Puerto Rico AAA Portfolio Target Maturity Fund,

Portfolio Bond Fund, Portfolio Bond Fund II, Puerto Rico GNMA & U.S. Government Target Maturity Fund, Puerto Rico Mortgage-Backed and U.S. Securities Funds, UBS IRA Selected Growth and Income Fund, Multi-Select Securities Puerto Rico Fund, and the Puerto Rico Short-Term Investment Fund. For the fiscal year ending July 31, 2009, León's aggregate compensation for service on the boards of funds advised or co-advised by UBS Trust was reported to be $68,531 (excluding expenses). *Id.* at 80a.

Nido also served on the boards of all of the Funds and also on at least two other UBS-related funds – the AAA Portfolio Bond Fund II and the Puerto Rico Short Term Investment Fund. *Id.* at 79a. For the fiscal year ending July 31, 2009, Nido's aggregate compensation for service on the boards of funds advised or co-advised by UBS Trust was reported to be $92,031 (excluding expenses). *Id.*

The remaining four Director Defendants, Agustín Cabrer-Roig, Gabriel Dolagaray-Balado, Luis M. Pellot-González and Clotilde Pérez, also served on multiple UBS-affiliated boards. *Id.* at 78a-80a.

B. The ERS Bond Transactions

Between January and June of 2008, UBS Financial underwrote $2.9 billion worth of near-junk bonds (the "ERS Bonds") issued by the Employee Retirement System of the Government of Puerto Rico (the "ERS" or the "System"). *Id.* at 84a. UBS Trust, acting as advisor for the Funds, caused the Funds and other closed-end funds it controlled, to purchase vast quantities of the ERS Bonds. *See id.* at 93a-96a.

The ERS bonds were offered for purchase in three series: Series A in January 2008; Series B in May 2008; and Series C in June 2008. *Id.* at 84a-87a. After UBS had placed the Series A offering of ERS Bonds in Puerto Rico, with the help of its captive Funds, it planned to pursue a global Series B offering. *See id.* at 85a-86a. UBS' Series A offering of ERS Bonds in Puerto Rico sparked little global interest, however; and, in lieu of a global offering, a new Series B of the ERS Bonds was offered in the local Puerto Rico market in late May 2008. *See id.* at 85a-86a. The Funds purchased over $430 million in ERS Bonds from this offering. *Id.* at 86a. In total, UBS Trust purchased approximately $1.5 billion of the ERS Bonds (more than half of the total bond offering) for twenty mutual funds, including the Funds, which it manages through its UBS Asset Managers of Puerto Rico division ("UBS Asset Managers"). *Id.* at 70a. Over $750 million in purchases of the near-junk ERS Bonds were now concentrated in the Funds. *Id.* at 85a-87a. The ERS Bond purchases by UBS Trust amounted to approximately 30% of the total holdings of each of Funds II, III, and IV, and approximately 15% of the total holdings of Tax-Free Fund II such that the Funds were overly concentrated in the low quality ERS Bonds. *Id.* at 88a. Within one year of issuance, the ERS bonds lost ten percent of their value, dragging down the worth of the Funds. *See id.* at 91a. These bond offerings resulted in approximately $27 million in fees for UBS Financial and its co-underwriters. *Id.* at 69a.

C. Proceedings Below

Respondents brought this action in February 2010 in the United States District Court for the District of Puerto Rico, on their own behalf, on behalf of a purported class,

and derivatively on behalf of the Funds, alleging federal and Commonwealth-based claims for Defendants' breaches of their statutory and other duties. The Complaint alleged that the Defendants engaged in a scheme of manipulative trading whereby they used the Funds to manufacture the appearance of market interest in the bonds to drive up the price other investors were willing to pay for them. The Complaint also averred that a pre-suit demand would have been futile. Defendants moved to dismiss the Complaint on the grounds that Plaintiffs had inadequately pleaded demand futility.

On March 31, 2011, United States District Judge Aida M. Delgado-Colón granted the Defendants' motion to dismiss the Complaint, without prejudice, primarily on the stated grounds that Plaintiffs failed to adequately plead demand futility with particularity, and thereafter entered Judgment. *Id.* at 28a-65a. Plaintiffs timely filed an appeal of the District Court's dismissal of their derivative claims to the First Circuit.

D. The First Circuit Vacates The District Court's Dismissal Of The Action

On January 4, 2013, the First Circuit vacated the District Court's decision dismissing the derivative claims and remanded the case for further proceedings. *Id.* at 1a-27a. In reaching its decision, the First Circuit appropriately utilized a *de novo* standard of review of the District Court's decision. Petitioners failed to petition for rehearing or to seek reconsideration by the First Circuit *en banc*.

E. Current Status Of The Case

On February 20, 2013, movants and proposed plaintiffs Dr. Wilmer Rodriguez Silva, Luis Colón Rivera, Jesus Norniella, individually and on behalf of the Norniella Family Trust, Humbert Donato and Amelia Solis, filed a motion to intervene as plaintiffs in the action in the place of Respondents, as questions had been raised about the original plaintiffs' standing to continue prosecuting the action. *See* No. 10-1141-ADC, Record No. 80.

On February 20, 2013, Petitioners moved to dismiss with prejudice the Complaint for lack of subject matter jurisdiction (the "Jurisdiction Motion"). *See id.*, Record No. 81. Both the motion to dismiss and motion to intervene are fully briefed and *sub judice.*

REASONS FOR DENYING THE PETITION

I. THIS CASE IS AN INAPPROPRIATE VEHICLE FOR EXAMINING THE PROPER STANDARD OF REVIEW OF DEMAND FUTILITY DECISIONS

A. The First Circuit Correctly Adopted The Modern *De Novo* Standard Of Review In Considering The District Court's Dismissal Of The Complaint

The court below was correct to utilize a *de novo* standard of review. Dismissals under Federal Rule of Civil Procedure 12(b)(6) are uniformly reviewed *de novo. See, e.g., Ruiz v. Bally Total Fitness Holding Corp.*, 496 F.3d 1, 5 (1st Cir. 2007); *Vitol, S.A. v. Primerose Shipping Co., Ltd.*, 708 F.3d 527, 543 (4th Cir. 2013); *Boyd v. Driver*, 495 F. App'x 518, 522 (5th Cir. 2012); *Speaker vs.*

U.S. Dept. of Health & Human Servs. Ctrs. for Disease Control & Prevention, 623 F.3d 1371, 1379 (11th Cir. 2010). The question of whether a shareholder has derivative standing turns, as does a 12(b)(6) determination, on the legal sufficiency of the complaint and should therefore also receive *de novo* review. Pet. App. at 12a ("As a general matter, rulings concerning the legal sufficiency of pleadings are reviewed de novo. There is no justification for treating the pleadings in a derivative suit differently.") (internal citation omitted).

In deciding the standard of review to apply to the District Court's dismissal of the action based on a failure to properly plead demand futility, the First Circuit correctly stated that its "decisions have left this question open." *Id.* at 10a (citations omitted). The First Circuit explained that its prior opinion, *Heit v. Baird*, 567 F.2d 1157, 1161 (1st Cir. 1977), which merely noted that the district court had not "abused its discretion" in dismissing a shareholder derivative action, did not establish the governing standard in the Circuit – which is confirmed by the absence of any statement to that effect in subsequent decisions within the Circuit. *See* Pet. App. at 10a.

In reaching its decision, the First Circuit paid careful attention to the fact that numerous circuits, including the Second, Ninth and D.C. Circuits, had recently expressed skepticism regarding the appropriateness of the application of an abuse of discretion standard. *Id.* at 11a. The First Circuit also considered that state courts have trended even more strongly toward plenary review of a trial court's dismissal for failure to plead demand futility. *Id.* Applying this reasoning, the First Circuit held that a district court's dismissal of a shareholder derivative suit based on a failure to plead demand futility was subject to *de novo* review. *Id.* at 12a.

The First Circuit then analyzed the legal precepts applied by the District Court and the court's choice and interpretation of those legal precepts and properly concluded the District Court had erred.

B. Petitioners Exaggerate The Purported Conflict Between Circuits

As the First Circuit's Opinion acknowledged, "[o]ther courts of appeals have traditionally reviewed the dismissal of a derivative suit based on a failure to properly plead demand futility for abuse of discretion." Pet. App. at 11a (citing *Potter v. Hughes*, 546 F.3d 1051, 1056 (9th Cir. 2008); *Kanter v. Barella*, 489 F.3d 170, 175 (3d Cir. 2007)). However, as the First Circuit's Opinion explained, "[r]ecently ... there have been expressions of skepticism regarding the appropriateness of [the abuse of discretion] standard from the Second Circuit, the Ninth Circuit, and the D.C. Circuit." Pet. App. at 11a (citing *Kautz v. Sugarman*, 456 F. App'x 16, 18 (2d Cir. 2011); *Scalisi*, 380 F.3d at 137 n.6; *Israni v. Bittman*, 473 F. App'x 548, 550 n.1 (9th Cir. 2012); *Laborers Int'l Union of N. Am. v. Bailey*, 310 F. App'x 128, 130 n.1 (9th Cir. 2009); *Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust v. Raines*, 534 F.3d 779, 783 n.2 (D.C. Cir. 2008)) (internal citations omitted).[3]

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3. *See also Staehr v. Alm*, 269 F. App'x 888, 891 (11th Cir. 2008) (declining to adopt *de novo* standard of review "because the established standard can only be altered by the Court *en banc*" and, "[i]n any event, [action was] not an appropriate case to reconsider the applicable standard, because Appellant loses under either mode of review"); *In re Abbott Labs. Deriv. S'holders Litig.*, 293 F.3d 378, 385-86 (7th Cir. 2002) (adopting *de novo* standard of review), *vacated and superseded by* 325 F.3d 795 (7th Cir. 2002).

The Courts of Appeals for the Fourth and Fifth Circuits have yet to address the appropriate standard of review at all. Petitioners ignore the fact, set forth in Respondent's reply brief to the First Circuit, that the Sixth Circuit adopted a *de novo* standard of review before the First Circuit.[4] And Petitioners completely fail to mention that, after the First Circuit issued its Opinion and before Petitioners filed their April 4, 2013 Petition to this Court, the Eighth Circuit also adopted and applied *de novo* review to a district court's dismissal on demand futility grounds, following argument by the parties over the appropriate standard of review. *See Gomes v. Am. Century Cos., Inc.*, 710 F.3d 811, 815 (8th Cir. 2013) (in reversing district court's dismissal of complaint for failure to make pre-suit demand, holding that "[w]e review *de novo* a district court's decision to grant a motion to dismiss, accepting the complaint's allegations as true") (citation omitted); 2012 WL 2330368, at *9 (Br. of *Gomes* Appellees); 2012 WL 2371174, at **16-17 (Reply Br. of *Gomes* Pl.-Appellant). Thus, Petitioners' assertion that the First Circuit's decision is "at odds with all other circuits" is wrong.[5]

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4. *See* No. 11-1605, Reply Br. of Pls.-Appellants (filed Oct. 11, 2011), at 4 (citing *In re Ferro Corp. Deriv. Litig.*, 511 F.3d 611, 616-17 (6th Cir. 2008) (reviewing sufficiency of Fed. R. Civ. P. 23.1 allegations under Fed. R. Civ. P. 12(b)(6) *de novo* standard); *McCall v. Scott*, 239 F.3d 808, 815, 817 (6th Cir. 2001) ("Rather than focusing upon the plaintiffs' claims of error, we review *de novo* the question of whether plaintiffs alleged with sufficient particularity facts that create a reasonable doubt as to the disinterestedness and independence of a majority of the directors.")).

5. According to Petitioners, "[t]he First Circuit's holding ... conflicts with decisions applying the abuse of discretion standard for Rule 23.1 dismissals as employed by the Second, Third, Seventh, Ninth, Tenth, Eleventh and D.C. Circuits." Pet. at 16 (citations omitted).

Moreover, as stated by former Justice Harlan, "even where a 'true' conflict may be said to exist, certiorari will sometimes be denied where it seems likely that the conflict may be resolved as a result of future cases in the Courts of Appeals...." Justice Harlan, *Some Aspects of the Judicial Process in the Supreme Court of the United States*, 33 Austl. L. J. 108, 112 (1959). Justice Harlan's cautionary observation is especially pertinent to this Petition. This is precisely the situation that counsels against granting certiorari here.

Some of the circuits that previously adopted an abuse of discretion standard of review appear inclined to discard that standard over time and follow the First, Sixth and Eighth Circuits' adoption of *de novo* review as the modern standard. As the Second Circuit said in *Scalisi*:

> the abuse of discretion standard is incongruous in this context: "[W]hen a trial court rules on the legal sufficiency of a complaint the question presented should be one of law. When an appellate court reviews such a ruling, review should be *de novo*."

380 F.3d at 137 n.6; *see also Israni*, 473 F. App'x at 550 n.1 ("We question whether abuse of discretion review is appropriate."); *Kautz*, 456 F. App'x at 18 (referring to "appropriate standard of review in demand futility cases" as "seem[ing] to be an open question") (citation omitted); *Laborers Int'l Union of N. Am.*, 310 F. App'x at 130 n.1 ("Appellants identify problems with the [abuse of discretion] standard of review .... We find Appellants' arguments persuasive, especially in light of the Delaware Supreme Court's rejection of the abuse of discretion standard in favor of de novo review.") (citations omitted);

Pirelli, 534 F.3d at 783 n.2 ("We tend to agree with plaintiffs that an abuse-of-discretion standard may not be logical in this kind of case, ... because the question whether demand is excused turns on the sufficiency of the complaint's allegations; and the legal sufficiency of a complaint's allegations is a question of law we typically review de novo.").[6]

Given the Sixth and Eighth Circuits' recent adoption of *de novo* review and the indications of interest among other Courts of Appeals in adopting that standard, this Court should deny the Petition to permit the circuits time to address the First Circuit's reasoning squarely and potentially to resolve on their own the question presented by the Petition. As Justice Harlan recognized, a petition for certiorari should be granted, based solely on a conflict among the circuits, "in instances where it is clear that the conflict is one that can be effectively resolved only by the prompt action of the Supreme Court alone." Harlan, *supra*, at 112. Until the circuits have had time to address and to resolve the narrow and relatively recent "conflict" among the circuits on this issue, this Court's prompt action on this issue is unnecessary.

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6. The First Circuit further observed that, in the demand futility context, "[s]tate courts have trended even more strongly toward plenary review." Pet. App. at 11a. For example, the First Circuit noted that the Delaware Supreme Court adopted a *de novo* standard of review in 2000, "explaining that the nature of its analysis of a complaint in a derivative suit is no different than that of a lower court." *Id.* (citing *Brehm*, 746 A.2d at 253-54). "The highest courts of other states have followed suit." Pet. App. at 11a (citing *Fink v. Codey (In re PSE&G S'holder Litig.)*, 801 A.2d 295, 313 (N.J. 2002); *Harhen v. Brown*, 730 N.E.2d 859, 866 (Mass. 2000)).

C. There Is No Compelling Reason To Grant Review In This Case

Petitioners offer no compelling reason for granting review in this case. Sup. Ct. R. 10 ("A petition for writ of certiorari will be granted only for compelling reasons."); *see id.* at 10(a) (referring to conflict between Courts of Appeals on an "important" matter). The Petition asks the Court to review a question of the proper standard of appellate review for a narrow and relatively obscure legal issue – *i.e.*, whether *de novo* review of a district court's dismissal of a shareholder derivative complaint on demand futility grounds was appropriate. This question is not one of national importance, affecting numerous litigants. *See, e.g., Superintendent, Mass. Corr. Inst., Walpole v. Hill*, 472 U.S. 445, 459 n.3 (1985) (Stevens, J., concurring in part and dissenting in part) ("In any event, this minor dispute hardly qualifies as ... one of national importance.") (internal citations omitted). Petitioners themselves did not consider the standard of review issue pressing enough to seek rehearing or reconsideration by the First Circuit *en banc* before filing their Petition.[7]

In addition, as explained above, the question presented is relatively recently-arisen and may be resolved by the circuits on their own. Yet, even if some circuits ultimately decline to follow the First Circuit, potential inconsistencies among outcomes should be minimal because many circuits employing the abuse of discretion standard also apply *de*

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7. Either of these procedures could have addressed Petitioners' incorrect assertion that the Opinion disregards the First Circuit's own precedent. *See* Pet. at 15.

novo/plenary review when questions of law are at issue – as is frequently the case in this context.[8]

II. RESPONDENTS WOULD PREVAIL EVEN IF PETITIONERS ARE AWARDED THE RELIEF THEY SEEK

Even assuming the First Circuit had declined to apply *de novo* review to the District Court's demand futility determinations, reversal would still have been appropriate.

A. As Petitioners Acknowledge, Review For Abuse Of Discretion Would Still Approximate And, In Some Instances, Require Plenary Or *De Novo* Review By The Appellate Court

Petitioners acknowledge that certain circuit courts apply a *de novo* or plenary standard to a District Court's

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8. *See, e.g., Cadle*, 272 F. App'x at 677 (in "conduct[ing] de novo review[,]" explaining that, "to the extent that the district court's decision under Rule 23.1 rests on a question of law or a mixed question of law and fact that primarily involves legal principles, our review is de novo") (internal citations omitted); *Scalisi*, 380 F.3d at 137 ("[W]here a challenge is made to the legal precepts applied by the district court in making a discretionary determination, plenary review of the district court's choice and interpretation of those legal precepts is appropriate.") (internal citations omitted); *Blasband*, 971 F.2d at 1040 ("[W]hile we review ... the district court's determination of demand futility ... under an abuse of discretion standard, we exercise plenary review over its choice of legal precepts upon which those determinations were based.") (internal citation omitted); *Starrels v. First Nat'l Bank of Chi.*, 870 F.2d 1168, 1170 (7th Cir. 1989) (explaining that "abuse-of-discretion standard" applies "assuming no error of law has been made").

decision under Rule 23.1 where the decision rests on a question of law *or* mixed question of law and fact that involves legal principles. Pet. at 23-24. This is such a case.

The First Circuit concluded, for example, that the District Court improperly failed to follow case law "requir[ing] the trial court to analyze more broadly the facts alleged concerning the circumstances of each director...." Pet. App. 16a (citation omitted). The First Circuit explained that the District Court "focused too narrowly on whether plaintiffs had alleged that the individual directors received a financial benefit from the ERS bonds transaction." *Id.*; *see id.* ("In other words, the [D]istrict [C]ourt should have considered whether plaintiffs had pled facts sufficient to demonstrate that each director has such significant connections to the defendants, whether personal, financial, or otherwise, that he could not 'impartially consider [demand] without being influenced by improper considerations.'") (quoting *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993)). The First Circuit also considered whether the District Court applied the proper burden on Plaintiffs on the motion and concluded that the "district court misconstrued plaintiffs' burden...." Pet. App. at 16a-17a. The First Circuit held that the District Court "repeatedly declined to make ... reasonable inferences of materiality from the facts alleged by plaintiffs" and erred as a matter of law in failing to consider the facts holistically. *Id.* at 16a-17a, 23a-26a.

> For example, the [D]istrict [C]ourt concluded that the allegations that one director was CEO of both institutional defendants did not raise a reasonable doubt about his ability to independently evaluate demand in this case because these facts were insufficient to

> establish that these positions were "subjectively material."

Id. at 17a; *see id.* at 20a-21a. The First Circuit explained that, "in looking for more conclusive evidence of materiality, the [District Court] overstated the burden plaintiff bears" and that the District Court "ignored the type of information available to plaintiffs at the pleading stage." *Id.* at 17a (citing *Rales*, 634 A.2d at 934 (reasoning that plaintiffs should not be saddled with an "extremely onerous burden to meet at the pleading stage without the benefit of discovery")).

Similarly, the First Circuit concluded that the District Court improperly failed to consider Respondents' allegations with respect to a second director "as a whole...." Pet. App. at 23a. The First Circuit concluded that, "[a]s both president of defendant UBS Financial and a director of each Fund," the director's "loyalties would necessarily be divided in evaluating his obligations to the Funds and his obligations to UBS Financial." *Id.* at 22a (citing *In re Verisign, Inc., Deriv. Litig.*, 531 F. Supp. 2d 1173, 1189 (N.D. Cal. 2007) ("Directorial 'interest' exists whenever divided loyalties are present....")). In addition, "as [p]resident of UBS Financial and CEO of another UBS AG affiliate," he was "beholden to the UBS defendants." Pet. App. at 22a (citing *In re NutriSystem, Inc. Deriv. Litig.*, 666 F. Supp. 2d 501, 515 (E.D. Pa. 2009) ("Delaware courts have found that directors ... lack independence because of their substantial interest in retaining their employment."); *In re The Student Loan Corp. Deriv. Litig.*, 2002 WL 75479, at *3 & n.3 (Del. Ch. Jan. 8, 2002) (concluding that directors who "owe[their] livelihood" to institutional defendants could not consider demand

without "ponder[ing] the effect affirmative action on a demand would have on [their] future"); *Rales*, 634 A.2d at 937; *Mizel v. Connelly*, 1999 WL 550369, at *3 (Del. Ch. Aug. 2, 1999) (finding that directors lacked independence where they could not "consider the demand on its merits without also pondering whether an affirmative vote would endanger their continued employment")).

With respect to a third director, the First Circuit held that the District Court:

> should have considered [the director's] previous relationships with both institutional defendants and the possibility that [the director] will need the assistance of the UBS defendants in the future as a constellation of facts which, considered together, create a reasonable doubt about [the director's] independence.

Pet. App. at 25a (citing *In re Trump Hotels S'holder Deriv. Litig.*, 2000 WL 1371317, at *8 (S.D.N.Y. Sept. 21, 2000) ("Courts have considered the possibility of future influence or remuneration as a factor when weighing director independence."); *Krantz*, 98 F. Supp. 2d at 156 (listing factors relevant to determining whether a director is controlled, including "former business associations between the director and the controlling person")); *see* Pet. App. at 24a ("the [D]istrict [C]ourt failed to consider the facts alleged as a whole about [the director's] relationships with the institutional defendants") (citing *In re Trump Hotels*, 2000 WL 1371317, at *9 (noting that while one allegation standing alone "is insufficient to raise a reasonable doubt[,] ... the totality of the circumstances raise[d] a reasonable doubt" as to the director's

independence)). The First Circuit further concluded that, with respect to that director, the District Court "failed to make reasonable, common sense inferences from the facts alleged in the complaint." Pet. App. at 25a (citing *In re Oracle Corp.*, 824 A.2d 917, 943 (Del. Ch. 2003) (reasoning that, in assessing a director's independence, the chancellor must "necessarily draw on a general sense of human nature")).[9]

These legal precepts and mixed questions of fact and law would have been reviewed anew even in circuits not acknowledging absolute *de novo* review of Rule 23.1 determinations. *See Scalisi*, 380 F.3d at 137; *Abbott Labs*, 325 F.3d at 803, 805 (noting appellate review of the legal precepts used by the district court and the court's interpretation of those precepts is plenary and finding district court failed to fully scrutinize Delaware case law and the necessary circumstances for application of the *Rales* test); *Salve Regina College v. Russell*, 499 U.S. 225, 231 (1991) ("a court of appeals should review *de novo* a district court's determination of state law"); *Cadle*, 272 F. App'x at 677 ("to the extent that the district court's decision under Rule 23.1 rests on a question of law or a mixed question of law and fact that primarily involves legal principles, our review is de novo"). Accordingly, the result in this case would have been the same in any of the jurisdictions recognizing the hybrid standard of review.

9. The First Circuit explained that its analysis of two additional directors was consistent with its analysis of the second and third directors described in the text above. *See* Pet. App. at 23a, 26a.

B. Respondents Would Prevail Even If The First Circuit Had Applied An Abuse Of Discretion Standard

Even if the First Circuit had applied a pure abuse of discretion standard to review the District Court's demand futility determinations, reversal would still be appropriate because the District Court clearly abused its discretion. A district court abuses its discretion if its "'decision rests upon a clearly erroneous finding of fact, an errant conclusion of law or an improper application of law to fact.'" *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 320 (3d Cir. 2008); *see also Mendez-Aponte v. Bonilla*, 645 F.3d 60, 68 (1st Cir. 2011).

The First Circuit made several determinations that the District Court improperly applied law to facts and made errant conclusions of law which would warrant reversal applying an abuse of discretion standard of review. Most egregiously, the District Court ruled that Plaintiffs had failed to sufficiently plead that Defendants Ubiñas and Roussin, employees of UBS Financial, were "interested" or lacked "independence" for demand futility purposes, despite the fact that those same defendants had conceded that they were not independent for futility purposes and the Complaint alleges that both of these Defendants worked for Defendant UBS Financial. Pet. App. at 77a-78a. It is a fundamental principle of corporate law that a director cannot impartially and independently consider a demand to sue his employer. *Primedia Inc. Deriv. Litig.*, 910 A.2d 248, 261 (Del. Ch. 2006); *Student Loan*, 2002 WL 75479, at *3. The District Court's error on this basic point supports the conclusion that, even assuming an abuse of discretion standard applies, that

standard is satisfied. *See Mendez-Aponte*, 645 F.3d at 68 ("A district court abuses its discretion when its ruling is based on an erroneous view of the law or on clearly erroneous factual findings").

With respect to Defendants Belaval and León, the District Court improperly failed to consider the facts alleged as a whole about these directors' relationships with the institutional defendants and the possibility that they would need the assistance of the UBS defendants in accessing financial markets in the future. *See* Pet. App. at 23a-26a (citing *In re Trump Hotels*, 2000 WL 1371317, at *8, *9). Indeed, both Defendants served as vice chairmen of Triple S, which, "[i]n the recent past, ... has enjoyed a lucrative relationship with UBS Financial and UBS Trust." Pet. App. at 23a. In addition, the District Court "failed to make reasonable, common sense inferences from the facts alleged in the complaint with respect to these Defendants." Pet. App. at 25a (citing *In re Oracle Corp.*, 824 A.2d at 943). The District Courts' foregoing errant conclusions of law and improper application of law to facts is also an abuse of discretion. *See In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d at 312.

The First Circuit's ruling in this action parallels that of the Ninth Circuit in *Lynch v. Rawls*, 429 F. App'x 641 (9th Cir. 2011), where the Ninth Circuit reversed the trial court's dismissal of a derivative action applying an abuse of discretion standard when the district court "drew inferences in favor of Defendants rather than Plaintiffs ... and analyzed Plaintiffs' allegations individually rather than collectively." *Lynch*, 429 F. App'x at 644. In *Lynch*, the Ninth Circuit (a Circuit upon which Defendants heavily rely to support their position) reversed and remanded the

trial court's dismissal of a derivative action under Rule 23.1 for the plaintiffs' failure to plead demand futility. *Id.*

The fact that on numerous occasions the Ninth and Second Circuits have acknowledged that applying either an abuse of discretion or *de novo* standard in analyzing Rule 23.1 dismissals would not change the outcome of the courts' ruling suggests that the First Circuit would have reached the same conclusion regardless of the standard it applied. *See N.A. Lambrecht v. O'Neal*, 2012 WL 6013440, at *3 (2d Cir. Dec. 4. 2012) (declining to address appropriate standard of review because either standard would result in the same conclusion); *Israni*, 473 F. App'x at 550 n.1 (same); *Kautz*, 456 F. App'x at 18 ("We decline to address here what seems to be an open question of the appropriate standard of review in demand futility cases ... because our ruling today would be required under either standard"); *Laborers Int'l Union of N. Am.*, 310 F. App'x at 130 n.1 (declining to address standard of review issue because either standard would result in the same conclusion); *Scalisi*, 380 F.3d at 137 n.6 (same).[10] Given that the standard of review would not change the outcome in this case – or in most cases – the question presented does not warrant review by this Court.

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10. For example, in *Israni*, the Ninth Circuit conducted a detailed analysis of the allegations in the plaintiffs' complaint to determine whether those allegations raised a reasonable doubt that the directors' actions were a valid exercise of business judgment and whether demand was excused based on the directors' fees paid, committee memberships and insider trading among directors. *Israni*, 473 F. App'x at 549. In other words, the Ninth Circuit conducted a similar analysis to the one the First Circuit engaged in below. In *Israni*, the appellate court affirmed the lower court's ruling and concluded that applying either the abuse of discretion or *de novo* standard would result in the same conclusion. *Id.* at 550.

CONCLUSION

For the foregoing reasons, Respondents respectfully request that the Court deny the Petition.

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