SCANNED ON 5/22/2007

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: HON. CHARLES E. RAMOS, Justice

PART 53

Index Number : 600645/2006
CARROLL, SHARON
vs
WEILL, SANFORD I.
Sequence Number : 006
CFE

INDEX NO. ______

MOTION DATE ______

MOTION SEQ. NO. ______

MOTION CAL. NO. ______

is motion to/for ______

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☒ No

Upon the foregoing papers, it is ordered that this motion

FILED
MAY 22 2007
NEW YORK
COUNTY CLERK'S OFFICE

is decided in accordance with accompanying memorandum decision and order.

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE
FOR THE FOLLOWING REASON(S):

Dated: 5/14/07

HON. CHARLES E. RAMOS J.S.C.

Check one: ☐ FINAL DISPOSITION ☑ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION

---------------------------------------X

SHARON CARROLL, derivatively on behalf of nominal defendant CITIGROUP, INC.

Plaintiff,

Index No. 600645/06

-against-

SANFORD I. WEILL, C. MICHAEL ARMSTRONG, ALAIN J.P. BELDA, GEORGE DAVID, KENNETH T. DERR, JOHN M. DEUTSCH, ROBERTO HERNANDEZ RAMIREZ, ANN DIBBLE JORDAN, DUDLEY C. MECUM, RICHARD D. PARSONS, ROBERT E. RUBIN, FRANKLIN A. THOMAS, STANLEY FISCHER, REUBEN MARK, ALFREDO HARP HELU, MICHAEL TERRY MASIN, ANDRALL E. PEARSON,

Defendants,

and

CITIGROUP, INC.,

Nominal Defendant.

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NEW YORK

Charles Edward Ramos, J.S.C.:

In Motion Seq. 006, the parties move jointly, pursuant to Business Corporation Law § 626 (d) and (e), for approval of the settlement of plaintiff's derivative action, against members of Citigroup's Board. Plaintiff's counsel also seek attorneys' fees and reimbursement of litigation expenses.

In Motion Seq. 004, the parties submitted their proposed settlement to the Court and requested a date for a fairness hearing. A hearing date was scheduled for December 14, 2006. Citigroup was also required to notify the shareholders of the proposed settlement. In response to the notice of proposed settlement, 29 individual shareholders filed objections with this Court. They have objected to either the substantive terms of the settlement, the attorneys' fees, or both. This decision will address their objections.

Oral presentations were made by plaintiff, defendants, and objectors Hochman and Mann. The first hearing was adjourned to give all parties a chance to review documents and submit further papers for the Court's review. A second hearing was held on February 28, 2007 and a third on March 1, 2007. Upon consideration of all the submissions and arguments, this Court finds that the proposed settlement is neither fair nor reasonable to Citigroup and its shareholders. The motion to approve the settlement in its present form is denied. The application for attorneys' fees is denied as moot.

Background

The complaint alleges that Citigroup was formed in 1998, its evolution into its present structure occurring after the repeal of the Glass-Steagall Act in 1999, which allowed financial enterprises to offer both commercial and investment banking services. It is a diversified global financial services holding company whose businesses provide a broad range of financial services to consumer and corporate customers. The company has over 200 million customer accounts in over 100 countries and territories and has approximately 300,000 employees. Citigroup stock trades on the New York Stock Exchange

The Individual Defendants named in the litigation are former and current Citigroup board members and/or officers. They are: Sanford I. Weill; C. Michael Armstrong; Alain J.P. Belda; George

David; Kenneth T. Derr; John M. Deutsch; Roberto Hernandez Ramirez; Ann Dibble Jordan; Dudley C. Mecum; Richard D. Parsons; Robert E. Rubin; Franklin A. Thomas; Stanley Fischer; Reuben Mark; Alfredo Harp Helu; Michael Terry Masin; Andrall E. Pearson (the "Individual Defendants").

Prior Litigation

In July 2002, plaintiff Sharon Carroll filed a shareholder derivative action, entitled *Carroll v Weill*, Index No. 602724/02 ("Action I"), against members of Citigroup's Board of Directors ("Board"), asserting claims for breach of fiduciary duty, gross mismanagement, and corporate waste. Four other complaints were subsequently filed in the Supreme Court of New York, New York County: *Weitschner v Armstrong, et al.*, Index No. 118473/02; *Conrad v Weill., et. al.*, Index No. 602758/02; *South Broadway Capital v Armstrong, et al.*, Index No. 602758/02; and *Hack & Krantz v Armstrong, et al.*, Index No. 602827/02.

On October 17, 2002, Action I was dismissed. Three of the four pending actions entered into stipulations of dismissal and the fourth was discontinued without prejudice to future litigation. A subsequent appeal of the dismissal of Action I was unsuccessful.

Along with these New York cases, several other derivative actions were filed in Delaware Chancery Court, asserting derivative claims for breach of fiduciary duty, mismanagement, and waste of corporate assets, arising out of the same conduct underlying plaintiff's claims. These cases were consolidated as

In Re Citigroup Inc. Shareholders Litigation, C.A. No. 19827. The Chancery Court heard argument on Citigroup's motion to dismiss based on plaintiffs' failure to satisfy the pre-action demand requirements of Court of Chancery Rule 23.1. It granted Citigroup's motion to dismiss, and the Delaware Supreme Court affirmed the Chancery Court in *Rabinovitz v Shapiro*, 2003 WL 22701635. The other case filed in Delaware Chancery Court, *David B. Shaev Profit Sharing Account v Armstrong et al., C.A. No. 1449-N*, asserted claims similar to those in the New York and Delaware cases. On February 27, 2006, the Chancery Court dismissed that complaint. Plaintiff Shaev unsuccessfully appealed that decision.

In December 2002, another action, *Fink v Weill, et al.*, No. 02 Civ 10250 (LTS), was filed in the Southern District of New York. Along with the claims asserted in the actions above, plaintiff Fink also asserted a claim that defendant directors violated §14(a) of the Securities and Exchange Act with regard to proxy statements for the annual elections of directors. According to Fink, the proxy statements used in connection with the annual election of directors included false and misleading statements because they failed to discuss Citigroup's risky transactions with Enron and other companies. The District Court granted defendants' motion to dismiss the complaint and denied plaintiff Fink's motion for leave to file a third amended complaint. (*Fink v Weill*, 2005 WL 2298224 (SDNY 2005)).

Plaintiff then pursued a different strategy. On May 25, 2004, plaintiff sent the Board a demand letter, requesting that Citigroup initiate legal action against members of the Board and certain officers to recover damages allegedly incurred by Citigroup in connection with transactions involving and relationships with Enron Corp., Worldcom, Inc., Dynegy Inc., Adelphia Communications Corp., and Parmalat S.p.A. In October 2004, the Board appointed a Special Committee to investigate plaintiff's allegations. Plaintiff then sent another demand letter in March 2005, which broadened the scope of her demands to include investigations of Citigroup's private banking operations in Japan, U.S. mutual funds, WorldCom, European bond-trading investigation, and research analyst conflicts of interest. Plaintiff then proceeded with this, her second Action.

Current Litigation

The current action ("Action II"), was initiated on February 24, 2006. Plaintiff's complaint alleges that the Board breached its fiduciary duties, grossly mismanaged the company, and wasted corporate assets by failing to implement adequate internal controls, which in turn led to a series of improper financial arrangements with publicly traded companies like WorldCom, Inc., Enron Corp., Dynegy, Inc., Adelphia Communications Corp., and Parmalat, S.P.A., as well as matters involving Citigroup's private banking operations in Japan, research analyst conflicts of interest, European bond trading, credit card foreign currency conversions, U.S. mutual funds, IPO allocation practices, and investments and activities in Argentina. The complaint further alleges that the Individual Defendants' acts and omissions have exposed Citigroup to significant liability in numerous outstanding litigations and regulatory investigations and have caused Citigroup to incur substantial losses, as well as damage to its reputation, goodwill, and its ability to conduct future operations. This new complaint repeats substantially all of the claims that have already been dismissed in this and other jurisdictions.

Plaintiff's counsel have finally come to recognize that there are significant obstacles to securing a judgment against these Individual Defendants. Those obstacles include: (i) the dismissal by State and Federal courts in New York and Delaware of four other shareholder derivative actions filed against members of Citigroup's Board and/or officers asserting claims and allegations similar to these alleged in Action II; (ii) the legal standard to sustain a claim against the Individual Defendants for breach of fiduciary duty - "the business judgment rule" - is extremely rigorous, and that Individual Defendants would argue that plaintiff is asserting a *Caremark*[1] claim, "possibly the

[1] The origin of these types of claims comes from a Delaware case with the same name. (see *In re Caremark Intern Inc. Derivative Litigation*, 698 A2d 959 (Del. Ch. 1996) (Del)). "Caremark Claims" are claims for a director's breach of duty of care by a "failure to monitor." In order to prove that directors breached their duty of care for failure to monitor, the Delaware court articulated a four factor test: "(1) directors knew or (2) should have known that violations of law were occurring, and in either event, (3) that the directors took no steps in a good faith effort to prevent or remedy that situation, and (4) that such failure proximately resulted in the losses complained of..." (id. at 971).

most difficult theory in corporation law upon which a plaintiff might hope to win a judgement." (*id.* quoting Caremark, 698 A2d at 967); (iii) the transactions and matters addressed in Action II have been investigated by multiple federal and state regulatory agencies, bankruptcy examiners, and numerous private litigants, and that, to date, no adverse findings have been made against any current or former Citigroup director; and (iv) the length and expense of the trial, including an appeal. In the face of these obstacles, plaintiff and her counsel decided to "settle" this action.

The Proposed Settlement

The settlement consists of four components. The first is a statement incorporated in the preamble of the stipulation that Action I and plaintiff's Demand Letters helped catalyze Citigroup's adoption of corporate governance measures that it had adopted "after July 2002." (*See* Stipulation of Settlement, ¶C, Ex. A) ("Set. Stip."). This Court notes the lack of clarity as to how the Demand Letters "catalyzed" the adoption of reforms that had been already instituted before the Demand Letters were sent. Also there is no mention of Action I, Action II or the Demand Letters in any of the materials sent out by Citigroup to its shareholders regarding the changes in their corporate governance. (*See Citigroup Initiatives Corporate Governance and Business Practices*, Spring 2003 and 2005). Notwithstanding plaintiffs assertions of its role in these changes, the Court would like to highlight that during this time, corporate governance reforms were also taking place within the financial industry due to the passage of the Sarbanes-Oxley Act of 2002 and new listing requirements for the New York Stock Exchange. (*See*, Aronson, Seth et al., *Shareholder Derivative Actions:From Cradle to Grave*, 1557 PLI/Corp 125, 185 (2006) and The Economist, *The Value of Trust - Wall Street*, June 8, 2002) ("On June 6 the Big Board [New York Stock Exchange] introduced new listing requirements that will, among other things, force them to have a majority of independent directors on their boards.").

The second component is a sweeping general release of all possible claims that could be asserted against the Individual Defendants[2]. (*Set. Stip.* at 7). The contemplated release is sweeping because the released claims include any and all wrongdoing from January 1, 1997 to the time that the settlement is signed. The Individual Defendants appear to be turning the settlement of an admittedly insupportable claim into an opportunity to extinguish all potential claims going back ten years.

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[2] The release states: "any and all claims, rights, causes of action, suits, and demands, whether based on any federal, state, statutory, or common law, including, without limitation, federal and state securities laws and claims under any federal or state law governing fiduciaries or the duties of fiduciaries, that relate to any events, transactions, acts, occurrences, statements, representations, misrepresentations, or omissions during the period from January 1, 1997 through the date of this Stipulation that are alleged, or could have been alleged, in the Original Action, the Demand Letters, and/or the Action, and that have been, could have been, or in the future might be asserted by any of Citigroup's shareholders on behalf of the Company against the Individual Defendants, or any other current or former director of the Company or of the Company's affiliates or subsidiaries..."

The third component is an agreement, presumably by the nominal defendant corporation, to "adopt, to the extent it has not already implemented" certain corporate governance measures[3]. (*id.* at 7, Ex. B).

The fourth component resulted in a further agreement that plaintiff's attorneys were to receive a legal fee of $3.3 million from the nominal defendant.[4] (*id* at ¶6; Report of Milton Mollen at 3, Ex. 6) ("Mollen Report").

Other than agreeing to abide by the terms of the stipulation, the Individual Defendants have made no commitments or promises. All of the consideration supporting this settlement

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[3] The governance measures are summarized as follows: (1) Citigroup will provide for election of directors by majority vote; (2) Citigroup will continue to implement the compensation provisions of the Five Point Plan; (3) Citigroup will formalize the creation of the Compliance and Control Committee to identify changes to corporate policy; (4) Citigroup's Chief Compliance Officer will provide, on a quarterly basis, a compliance report to the Board's Audit and Risk Management Committee, and will certify that sufficient budget resources are committed to the compliance function to execute compliance goals and objectives; (5) Citigroup's Chief Auditor will certify to the Board's Audit and Risk Management Committee that sufficient budget resources are committed for the Company to execute its compliance and audit objectives; and (6) Citigroup will engage outside counsel to conduct an annual review of its governance and compliance policies and procedures.

[4] The parties agreed that an independent mediator, selected by the parties, would approve the amount of attorneys' fees and expenses through "binding mediation." The parties had agreed to set a range between $2 million and $4 million. The parties chose Milton Mollen, a retired Justice of the Appellate Division of the New York Supreme Court ("Justice Mollen"), to mediate the plaintiff's request for an award of fees and expenses. The mediation was held on June 15, 2006. During mediation, Justice Mollen was able to get the parties to agree that a $3.3 million fee and expense award was a justified amount.

is to be provided by the nominal defendant, Citigroup Inc., presumably for its own benefit. The actual defendants, the former and present directors and officers of the corporation, are granted a general release in exchange for nothing.

Notice and Objections

On September 6, 2006, this Court signed the parties' Amended Order Directing the Issuance of Notice and Setting a Fairness Hearing ("The Order") directing Citigroup to give notice to its shareholders. As a result of the notice publication and mailings, twenty nine shareholders have objected to the Settlement and/or Fee Application, or the Notice. ("The Objectors"). The objections fall into three categories:(i) Settlement Objectors; (ii) Fee Objectors; and (iii) Notice Objectors. Out of the twenty nine objections, eight objected to the Settlement itself ("Settlement Objectors"), twenty-four objections were lodged against the Fee Application ("Fee Objectors"), and two objections to the Notice ("Notice Objectors"). To date, no objections have been filed by institutional investors and/or large investors.

With regard to the compromise of derivative action claims, Business Corporation Law §§ 626 (d) and (e), provide:

> (d) Such action shall not be discontinued, compromised, or settled, without the approval of the court having jurisdiction of the action. If the court shall determine that the interests of the shareholders or any class or classes thereof will be substantially affected by such discontinuance, compromise, or settlement, the court in its discretion, may direct that notice, by publication or otherwise, shall be given to the shareholders or class of classes thereof whose interest it determines will be so affected; if notice is so directed to be given, the court

> may determine which one or more of the parties to the action shall bear the expense of giving the same, in such amount as the court shall determine and find to be reasonable in the circumstances, and the amount of such expense shall be awarded as special costs of the action and recoverable in the same manner as statutory taxable costs.
>
> (e) If the action on behalf of the corporation was successful, in whole or in part, or if anything was received by the plaintiff or plaintiffs or a claimant or claimants as the result of a judgment, compromise or settlement of an action or claim, the court may award the plaintiff or plaintiffs, claimant or claimants, reasonable expenses, including reasonable attorney's fees, and shall direct him or them to account to the corporation for the remainder of the proceeds so received by him or them. This paragraph shall not apply to any judgment rendered for the benefit of injured shareholders only and limited to a recovery of the loss or damage sustained by them.

Plaintiff argues, pursuant to § 626(d), that this Court should approve the settlement because the law favors settlement, only a few shareholders have objected to the settlement, the experience and views of counsel favor approval, and, ultimately, it is fair, reasonable, and adequate. However, in support of her argument that the settlement is "fair and reasonable," plaintiff obscures the distinction between her interests and the interests of the corporation. She primarily balances the continuing risks (cost) of litigation against the benefits afforded Citigroup and the lack of immediacy and certainty of a recovery. However, the costs to be incurred by plaintiff do not serve as a basis for the corporation to settle and therefore should not be played off against benefits afforded to Citigroup. In addition, the costs to the corporation should be moderate, given its status as a nominal defendant and the insurance coverage provided by its directors' and officers' liability policy. The only ascertainable and credible benefit to the corporation is closure of an unnecessary litigation.

In arguing that it is in the best interests of the plaintiff as a shareholder to end this litigation, plaintiff has admitted the extreme difficulty of proving liability, damages and sustaining judgement, and concludes that ending this litigation by settlement is far more rational than the continued cost of litigation. Indeed, as mentioned above, seven courts have dismissed identical claims. This application for approval of this settlement is hardly a ringing endorsement of the merits of this case.

In highlighting the extreme difficulty of proving liability, plaintiff admits that after conducting discovery, counsel did not uncover any evidence that the Individual Defendants in Action II committed any actionable misconduct. Along with not uncovering any evidence that would implicate the Individual Defendants, plaintiff was well aware that the Individual Defendants have defenses that could be raised in a motion to dismiss and that these defenses had the possibility of defeating the action before it even reached the trial stage. Plaintiff also admits that the legal standard for proving breach of fiduciary duty is extremely high, and even more demanding is the standard for "Caremark" claims, which Individual Defendants could argue is the theory upon which plaintiff rests her case. In addition, there are external checks, in the form of the other dismissed complaints, which plaintiff suggests demonstrate that the likely result would be a dismissal if the claims asserted herein go forward.

In light of the above, it is not a surprise that plaintiff urges this Court to approve this settlement.

Individual Defendants' Arguments

The Individual Defendants in Action II argue in conclusory fashion for approval. Defendants make the same arguments as plaintiff in favor of the approval of the settlement. Assuming for the moment that any benefits are attributable to the efforts of the plaintiff, the only credible benefit that would serve the interest of Citigroup and its shareholders is that the corporate governance reforms provide some non-pecuniary benefits and that closure will eliminate the disruptive and distracting effects of litigation against management and the Board. Although this Court is confident that the reforms are beneficial because they increase the ability of the Company to avoid reputational, monetary, and other damage, our concern is that the submissions supporting this settlement make it clear that plaintiff's efforts merely duplicated the corporation's prior independent efforts at internal reform.

Objectors' Arguments

Of the twenty-nine objections filed, the most active Objectors have been Leonard Mann[5] and Stephen Hochman. Mann

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[5] In addition to replying to Objector Mann's contentions, defense counsel notes that Mr. Schonbrun, lead counsel for Mr. Mann, has been admonished, and in some cases barred, by courts in California, Illinois, New York, Pennsylvania, and Texas, and others, for submitting very similar requests and objections. The Court took notice but does not consider these attacks on counsel to be relevant.

filed his initial objection on December 14, 2006, and subsequently filed four additional briefs[6] in opposition in response to the proposed settlement and fee award. Mann's main contention is that the settlement, as proposed, is not in the best interests of the shareholders, and that the attorneys' fees are excessive. Mann argues that the settlement cannot be considered fair, reasonable, and adequate because the level of cooperation between the settling parties demonstrates chicanery, which would render approval of the settlement improper. To demonstrate his allegation of "mutual back scratching," Mann first points to the underlying claims of Action II, and argues that the complaint only calls for relief in the form of monetary compensation for damages suffered by the corporation and that corporate governance changes were never contemplated as a form of relief. Furthermore, the changes that persons associated with the settlement assert were caused by plaintiff's complaint and demand letters were, in fact, already occurring and therefore cannot be properly attributed to plaintiff and her counsel. Lastly, Mann points to both plaintiff's counsel and defense

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[6] Responsive Brief in Opposition to Plaintiffs' Counsel's Request for $3.3 Million in Attorneys' Fees and Request for Hearing ("Mann Brief I")(January 24, 2007); Responsive Brief in Opposition to Proposed Settlement including $3.3 Million in Attorneys' Fees ("Mann Brief II")(February 1, 2007); Responsive Declaration of Shareholder's Counsel, Lawrence W. Schonbrun, to Defendants' Response to the Objections to the Proposed Settlement ("Mann Brief III") (February 21, 2007); Responsive Brief Re Expert Testimony of Robert Monks ("Mann Brief IV")(March 15, 2007).

counsel agreeing that there was no evidence supporting any of the accusations of director misconduct, but yet no explanation is proffered as to why Action II would not be dismissed on motion, just like all the other lawsuits.

Objector Hochman filed his initial objection letter on November 27, 2006 ("Hochman Letter I"), and subsequently filed two additional letters ("Hochman Letter II") (March 8, 2007) and ("Hochman Letter III") (April 2, 2007) after the fairness hearings held on February 28, 2007 and March 1, 2007. He argues that the application for the approval of the settlement should not be granted because the two alternatives that would occur if this Court were to reject the settlement would be more advantageous to Citigroup than approval of the settlement. The two possibilities that Hochman suggests are (i) that plaintiff's counsel will realize that it will not be awarded any fees unless it obtains evidence sufficient to convince one or more of the Individual Defendants to settle by reimbursing the corporation for some portion of the damages that he or she allegedly caused the corporation[7] or (ii) that plaintiff's counsel will "fold its tents" and go home, realizing that it made the mistake of bringing a case that it could not win.[8]

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[7] Hochman also states that if plaintiff's counsel chooses this possibility and succeeds in recovering damages from any of the defendants for the benefit of Citigroup, he would support an application by plaintiff's counsel for legal fees of up to one-third of the amount it recovers for Citigroup from defendants.
[8] Hochman points out several "mistakes" that plaintiff's counsel made in their pleadings. The first mistake was that counsel failed to add Jack Grubman and other senior officers of Citigroup as defendants in this case, who may have been personally involved

Hochman further contends that instead of obtaining a recovery for the benefit of Citigroup, plaintiff is allowing officers and directors, some of whom must have been guilty of the misconduct which caused damage to the corporation, to be released from liability for such damage as part of a settlement in which they do not compensate the corporation in an amount reasonably related to their risk of liability to the corporation for the damage allegedly caused, or in any amount at all. (*id.* at 3-4 and Hochman Letter III at 2-3). Lastly, as a policy consideration, disapproval of this settlement will send a message to directors of corporations who may be sued in derivative actions that they cannot buy themselves a "get out of jail free" card in the form of a broad release of liability for their conduct when they give no consideration other than agreeing not to oppose a fee application by plaintiff's counsel. (Hochman Letter II, at 4).

General Principles and Standards For Approval of Settlements

A shareholder derivative action is a "claim pressed by the stockholder against directors or third parties [that] is not his [or her] own but the corporations." (*In Re Salomon Inc. Shareholders' Derivative Litigation*, 1994 WL 533595 at *4, 1994 US Dist Lexis 13874 (SDNY 1994) (quoting *Ross v Bernhard* 396, US 531, 538 (1970)) quoting *Koster v Lubermans Mut. Cas. Co.*, 330 US

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with the fraudulent conduct leading to the "Worldcom Debacle" alleged in ¶¶ 70-79 of the complaint. She also failed to allege a fraud claim against any of the directors as well as failing to allege that any of the defendants had any personal involvement in the "debacles" alleged in ¶¶ 64-176 of the complaint.

518, 522 (1947)). The shareholders' derivative form of action is a "means of ensuring corporate management [is acting] in the interests of the shareholders and redressing abuses of trust by corporate officers and directors." (*In re Salomon*, 1994 WL 533595 at *6; *see also Bansbach v Zinn*, 1 NY3d 1, 8, 2003). Therefore, in adjudicating shareholder derivative claims, courts must be vigilant in protecting the interests of the corporation and shareholders. New York recognizes the court's role in protecting the interest of corporations and shareholders pursuant to §626(d) of the New York Business Corporation Law.

The rational behind giving trial courts the responsibility to review settlements is "to discourage the private settlement of a derivative claim under which a shareholder-plaintiff and his attorney personally profit to the exclusion of the corporation and the other shareholders..."[9] (*Mokhiber on Behalf of Ford Motor Co v Cohn*, 783 F2d 26, 27 (2d Cir 1986); *see also Kaplan v Rand*, 192 F3d 60, 67 [quoting *Bell Atl. Corp v Bolger*, 2 F3d

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[9] This rationale also underlies Federal Rule of Civil Procedure 23.1 (derivative actions), which was enacted separately from Federal Rule of Civil Procedure 23 (class actions). The underlying rationale of Federal Rule 23 was the basis upon which both Federal Rule 23.1 and New York Business Corporation Law §626 were modeled. (*Craftsman Finance & Mortg. Co. v Brown*, 64 F Supp 168, 178-79 (SDNY 1945); *Mokhiber*, 783 F2d at 27). The need for judicial oversight addressed in the Federal Rules and the BCL has been addressed by the courts as well. For example, the Seventh Circuit has stated that the district judge has a "judicial duty to protect the members of a class in class action litigation from lawyers for the class who may, in derogation of their professional and fiduciary obligations, place their pecuniary self-interest ahead of that of the class." (*Reynolds v Beneficial Nat. Bank*, 288 F3d 277, 285 (7th Cir. 2002).

1304, 1310 (3rd Cir 1993]). In order to prevent parties from engaging in such behavior, courts are required to review the settlement to ensure that it is fair and reasonable. In conducting this review, courts must carefully scrutinize the settlement and objectively analyze the evidence and circumstances before it, and courts must afford absent stockholders full and adequate notice and an opportunity to be heard on the settlement. (*See Levey v Babb*, 39 Misc 2d 648, 661 (Sup. Ct., NY County, 1963); *Siegal v Merrick*, 590 F2d 35, 37 (2d Cir 1978); *In re Cendant Corp., Derivative Action Litig.* 232 F Supp 2d 327, 332 (DNJ 2002)(quoting *In Re Cendant Corp. Litig.*, 264 F3d 201, 231 (3rd Cir 2001)). Furthermore, the Court should consider whether the settlement was negotiated at arm's length, is free from fraud and collusion, and is in the best interests of the corporation and shareholders. (*Zenn v Anzalone*, 17 Misc 2d 897, 900 (Sup. Ct., NY County, 1959), *app. dismissed* 11 AD2d 938 (1st Dep't 1960); *see Goldscholl v Shapiro*, 417 F Supp 1291 (SDNY 1976)).

In determining what is fair and reasonable, courts are to consider "the likelihood of success of the action, were it to proceed, analyzing the complexity of the law and difficulty in proving facts, on the one hand, to the settlements relief, on the other," (*In Re AOL Time Warner, Inc. Secs. Litig.*, 2006 US Dist. Lexis 49162 (SDNY 2006). Along with weighing the costs and benefits to the parties, the Court should consider the support or non-support of the interested parties, the likely duration and cost of continued litigation, the reasonableness of the settlement in light of the best possible recovery, and finally, the overall fairness of the settlement. (*See In Re N.Y. Stock Exchange/Archipelago Merger Litigation*, 2005 WL 4279476 at *9 (Sup. Ct., New York, 2005)).

Another important aspect of this case is the fact that it involves Citigroup, the largest bank in the world by market capitalization. This Court must analyze the factors above against the backdrop of the financial scandals that have rocked the financial community.[10] These scandals have eroded the public's confidence in corporate boards[11] and have created a perception that they, along with managers, have been complacent in allowing some of the corporate misbehavior that has plagued the industry in recent years.[12]

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[10] The Economist, *Just Deserts?*, April 17, 2004. ("In the past year or two, scandal has touched just about every corner of America's financial industry. Last year Wall Street firms (including Citigroup and J.P. Morgan Chase, as well as pure investment banks) paid a total of $1.4 billion in fines and compensation for failing to deal with conflicts of interest between research and securities underwriting during the tech-stock boom. Bank of America and FleetBoston Financial recently agreed to pay $675m in penalties and fee cuts to settle allegations of wrongdoing in trading mutual funds. Banks' reputations have also been stained by the corporate scandals at Enron, WorldCom and Parmalat.)

[11] The Economist, *The Value of Trust*, June 8, 2002. ("Investors have had their confidence bashed by a series of revelations of corporate malpractice and number fiddling before the stockmarket bubble burst.)

[12] *id.* ("Investors have not only lost patience with corporate America's greed and its inability to do what it says it is doing; they have lost confidence in Wall Street's ability to act as an honest broker between them, the providers of capital, and the corporate users of it."); The Economist, *No More Mr. Nice Guy*, March 20, 2004 ("The rash of corporate scandals over the past few years has produced not only outrage at the greed and shenanigans

In the wake of these scandals, the public has been asking the courts, legislators, and regulatory agencies to enforce existing rules, particularly in the area of officer and director responsibility, so that the public may once again have confidence in corporate culture and capital markets.

Procedural Aspects of the Settlement

In approving settlements, the Court must be convinced that the interests of the shareholders and corporation are protected. When examining the procedural aspects of settlement, the Court must examine not only whether the parties negotiated at arm's length, which is the main factor upon which plaintiff has focused, but also whether the parties have engaged in discovery and have the experience and ability to effectively represent the class's interests. (*AOL/Time Warner,* US Dist Lexis 49162 at *8).

There is no doubt that all parties are represented by very experienced counsel. Nor is there any doubt that counsel would approve of this settlement and the attorneys' fees because, as plaintiff's own counsel has stated, "although plaintiff believed her allegations to be meritorious, Plaintiff was quite cognizant that she faced steep and significant hurdles in surviving a motion for summary judgment, let alone securing a judgment against any of the Individual Defendants at trial." (Robbins Aff. at 60, ¶65).

Substantive Terms of the Settlement

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of top executives, but also incredulity that their boards of directors went along with their misdeeds.")

Just because adverse parties have negotiated at arms-length or engaged in discovery does not immunize them from judicial scrutiny as to the terms of the settlement. (*See Polar Int'l Brokerage Corp. v Reeve*, 187 FRD 108, 112 (SDNY 1999), dismissed by 108 FSupp 2d 225 (SDNY 2000)). There is an inherent agency problem in the context of settlement negotiations because of the risk of individuals putting their pecuniary self-interest ahead of other group or global interests. In this case, the underlying claim against the Individual Defendants was the breach of their fiduciary duty by failing to create adequate internal controls that led to the "debacles" with Worldcom, Enron, Adelphia, Dynegy, and Parmalat, waste of corporate assets, and gross mismanagement. Plaintiff admits she has not been able to find any evidence, despite conducting discovery, that would indicate Individual Defendants failed to implement adequate controls, wasted corporate assets, or grossly mismanaged. Although this Court has not adjudicated the claims underlying this matter, both parties have made it clear that plaintiff would have a difficult time in proving the merits of her claims. Yet, as several objectors have pointed out, defendants did not immediately move for a motion to dismiss. Instead defendants negotiated a settlement containing a release provision that, objectants argue, will serve the interests of the Individual Defendants at the expense of the company and a $3.3 million dollar attorneys' fee that will enrich plaintiff's attorneys at the expense of the company.

It is well established that a court should not substitute its own business judgment for that of the parties (*Republic Nat. Life Ins. Co. v Beasley*, 73 FRD 658, 667 (SDNY 1977); *Maher v Zapata Corp.*, 714 F2d 436, 455 (5th Cir 1983)), but that does not mean the Court should rubber stamp what the parties to the settlement agree is fair and equitable. (*Merrick*, 590 F2d at 37).

Response of the Shareholders

The settling parties put much emphasis on the fact that 2.2 million notices were sent out and that there were only a few objectors. Nevertheless, this Court must take each and every objection seriously in order to protect the interests of the shareholders and the corporation. The number of objections or the sophistication of those objections should not be dispositive on whether the settlement is fair and reasonable. (*See Polar* 187 FRD at 113-14)(The lack of substantial opposition in favor of settlement should not be dispositive. "In assessing a settlement, the court's duty is to protect absent class members, and thus it must reject a settlement it determines to be inadequate or unfair..."). The objectants do not need to number 2.2 million, they only need to be right.

Benefits to Citigroup vs the Probability of Recovery on the Merits

The purpose of a shareholder derivative suit is to provide a real or "substantial" benefit to the corporation. What is troubling in this case is the disparity between the allegedly negotiated reforms and the sweeping general release, as well as the absence of any consideration from the Individual Defendants. The "benefits" set forth in the stipulation, "do not impress one as very significant" (*In re Interpublic Securities Litigation*, 2004 WL 2397190 (SDNY 2004) at *10 2004 US Dist Lexis 21429, quoting *In Re Caremark* 698 A2d at 970) and the releases and payment of plaintiff's attorneys' fees are prejudicial to Citigroup and its shareholders.

This Court will not approve the settlement because of the release. Furthermore, the consideration for the broad general release (i.e. corporate governance benefits) is unconscionable because plaintiff's role in bringing forth these changes is attenuated at best. Finally, if this settlement is approved it will be setting a dangerous precedent in that plaintiff's counsel with admittedly meritless claims will be using meritless litigation as leverage to negotiate large legal fees in exchange for illusory benefits to the corporation and broad general releases granted to management.

Defendants argue that the release is not a general release. ("The language of the release is standard. It does not provide a general release, but rather only a release pertaining to this litigation and any claims arising from the alleged conduct underlying this litigation.") (Defendants Supplemental Memorandum of Law in Further Response to the Objections to the Proposed Settlement at 6) ("Defendant Memo III").

A general release "by its terms releases all claims, actions, and damages arising from or relating to a particular incident or event or relationship between the parties." (29 Lord, Williston on Contracts §73:4, at 13 [4th ed]). The release in this case states "any and all claims, rights, causes of action, suits, and demands..." (Defendant Memo III at 6). Along with trying to release all claims, Individual Defendants are also trying to extend the protection of the release for a time period of ten years (1997-2007) when in fact the plaintiff asserted claims for events taking place between 1997 and 2005.

It is the defendants who are trying to pull a sleight of hand here by categorizing this as a specific release. Defendants further justify the scope of the release on the basis that similar actions and regulatory agencies have not found any wrongdoing on the part of Individual Defendants. ("Neither plaintiff here nor any of the multiple regulators and bankruptcy examiners who have thoroughly examined these same issues have uncovered evidence of such wrongdoing.") (*id.* at 7). Defendants fail to acknowledge that all of these investigations and cases have dealt with the same events, transactions, acts, occurrences, statements, representations, misrepresentations, or omissions that plaintiff chose to pursue. The release on the other hand is not limited to acts, occurrences, statements, representations, or omissions with regards to the corporations that were part of plaintiff's action but rather it will preclude Citigroup's shareholders, in derivative form, from bringing <u>any</u> claims against directors based on events, occurrences, acts, omission, during the period from January 1, 1997 through the date of this stipulation. ("any and all claims...that relate to events, transactions, acts, occurrences...from January 2007 through the date of this stipulation... [that] in the future might be asserted by any of Citigroup's shareholders on behalf of the company against the Individual Defendants...") (Set. Stip. at 7).

In this case, the Individual Defendants are leveraging the limited scope of plaintiff's meritless claim in return for a broad general release that is not limited to claims that plaintiff asserted or could have asserted, but includes all claims that other Citigroup shareholders can assert, or in the future may assert, against the Individual Defendants from the period between January 1, 1997 and June 2007.

Plaintiff and Individual Defendants argue that the corporate governance reforms attributable to the efforts of the plaintiff are of great benefit to the company in light of the challenges faced in going forward with the litigation. Therefore, they urge this Court to approve the settlement because the broad general release exchanged for the corporate governance reforms (that Citigroup was already in the process of implementing) coupled with the cost savings of litigating an insupportable claim, serve the best interests of Citigroup and its shareholders. Defendants attempt to convince this Court that the standard for determining what is fair and reasonable should be a simple cost/benefit analysis of the costs of litigation in monetary terms and the benefits achieved. ("[T]his court does not need to find that the settlement consideration constitutes a "substantial benefit" to Citigroup in order to approve a settlement) (Defendant Memo III at 4, fn. 4); ("The settlement provides the Company [Citigroup] with closure, in the form of standard releases, thus putting an end to what has been expensive, time-consuming, and burdensome litigation first commenced in 2002) (Memorandum of the Individual Defendants and Citigroup Pursuant to the Court's Order of September 6, 2006 in Support of the December 14 Hearing Scheduled By That Order to Consider Final Approval of the Settlement) ("Defendant Memo I").

If we extend defendants rationale a little further they are asserting the position that any monetary savings in litigation costs can justify a broad release of claims because there is a benefit. However, the standard is a "substantial benefit," and not any benefit. (*Chan v Diamond*, 2005 WL 941477 *3 (SDNY 2005)) (Court approved a settlement that contained corporate remedial measures that the company would not have implemented on its own because the reforms provide a substantial non-monetary benefit to the company.)

Defendants argument that they are saving Citigroup expensive legal fees and litigation is a red herring. It is obvious that whenever derivative litigation is terminated a corporation always saves money. "[T]he district courts must review settlements in derivative litigation in which attorney's fees will be sought with great care to ensure that a fee is not assessed...unless the corporation has received a substantial benefit from the litigation and not simply from its settlement. After all, when derivative litigation is terminated a corporation always can be said to have obtained a benefit as it will save further legal fees." (*Zucker v Westinghouse Electric Corp.*, 265 F3d 171, 178) (3rd Cir 2001). Many courts have become "too willing perhaps, to find a substantial benefit when the derivative action settles, the plaintiff seeks attorneys' fees, and the defendant does not object." (Mark J. Lowenstein, *Shareholder Derivative Litigation and Corporate Governance,* 24 Del. J. Corp. L. 1, 1999). This is exactly how plaintiff and defendants have structured their arguments and the settlement in the hope that this Court will find a "benefit" and grant attorneys' fees. However, this Court must find that a substantial benefit accrued to Citigroup, and in this case it simply does not exist. ("This evolution from common fund to substantial benefit, combined with judicial reluctance to scrutinize derivative action settlements, has meant that the value of the "benefit" obtained by "successful" plaintiffs has often been insubstantial.") *id.*

Another reason for finding this settlement unfair and unreasonable is the attenuated connection between plaintiffs and the reforms for which they take credit. Presumably, the consideration to be exchanged for the release are the corporate governance reforms. However, many of the changes referenced in the *Citigroup Initiatives Corporate Governance and Business Practices* and the *Corporate Governance Guidelines* are those that were already being implemented by Citigroup, the industry, or toward which industry standards were moving. In fact, the stipulation does not attribute the reforms to the plaintiff and her expert (LENS Group.)[13]

It is not clear from the record what role plaintiff had in the reforms that took place at Citigroup. The submissions appear to be deliberately vague on this issue. Various names have been used to describe plaintiff's role including "among" and "catalyst," but as plaintiff's own expert admitted in his testimony, there is no way of determining which reforms were specifically instituted because of plaintiff's Action and Demand Letters.

> "The Court: How do I determine to what extent the actions of the ... plaintiff was responsible for these alterations in corporate governance as opposed to what you have described and every one seems to agree has been an otherwise excellent board of directors responding to an obvious problem of a multi billion dollar story?"
> The Witness (Mr. Monks): Solomon, in his wisdom, could not slice this baby up and tell you which part was attributable to what." (Fairness Hearing Transcript II, 97:9-97:23).

Furthermore, Mr. Monks breaks down the negotiated reforms, the reforms that plaintiff takes direct credit for, into three groups. In his view, the first group, majority voting, was a change that Citigroup would have taken regardless of plaintiff's involvement. (Fairness Hearing Transcript II, 99:11-18). The second group includes governance aspects where Citigroup already had an informal policy that was formalized by plaintiff's

[13] LENS Governance Advisors is a corporate governance and shareholder advisory firm headquartered in Portland, Maine.

demands.[14] (*id.* at 99:21). The third group includes those reforms which plaintiff claims are solely attributable to her.[15] (*id.* at 104:22-26). However, despite this claim, there is no acknowledgment of plaintiff's role in the adoption of these reforms by Citigroup in the stipulation.

In return for these reforms, the Individual Defendants are not promising anything in return. In the end, Citigroup is left with releasing potential claims, and no assurance that any of the corporate reforms will actually be implemented or even considered for any period of time.[16] In similar actions where there is an attempt to shape corporate governance reforms, parties have agreed to either keep the reforms in place for a significant amount of time or create a mechanism by which the Individual Defendants will be held accountable to the reforms. (*Interpublic*, 2004 WL 2397190 SDNY 2004)(Court rejected the parties original settlement in which the parties exchanged broad releases for two modest reforms in corporate governance. The court did highlight the usefulness of negotiations for at least getting the company to agree to keep the new corporate governance reform mechanism in place for five years.); (*AOL/Time Warner*, 2006 US Dist. Lexis 49162 SDNY 2006); (The settlement contained a

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14 The second group includes #2. *see infra* pg.8.

15 The reforms that fall within the third group are #5 and #6. *see infra* pg.8.

16 Independent of the stipulation, Citigroup as nominal defendant has stated it will commit to the reforms for at least three years. (Fairness Hearing Transcript II, 17:14).

commitment to fully fund, implement, and support all governance and compliance systems for at least four years.); (*In Re Critical Path, Inc., US Dist Lexis 22378* (ND Cal 2003) (Court ordered the parties to a settlement to recommend a procedure by which parties could monitor the progress of the proposed corporate governance policies, and the parties agreed to publish a follow up report on the corporate governance policies to be included in the audit committee's report in the annual proxy statement for the next five years.); (*Schwartz v TXU,* US Dist Lexis 28453 (ND Tex 2005))(Settlement provided that TXU corporation would implement and maintain corporate governance reforms and enhancements for seven years.); (*Cohn v Nelson*, 375 F Supp 2d 844 (ED Mo 2005)) (Settlement provided that all corporate governance reforms must be implemented and maintained for a period of no less than three years and that they can only be modified by an approval of a majority of independent directors who must, within 30 days, propose good faith alternative to the modified or eliminated reforms.).

Citigroup's benefit from discontinuing this action, is a mirage. The prior action was dismissed, all other actions in New York were voluntarily discontinued, all Delaware actions were dismissed, the Federal action was dismissed, the plaintiff filed this action re-pleading all of the dismissed claims, and she now seeks to settle this action exchanging payment of her legal fees for a general release from Citigroup and its shareholders to the Individual Defendants.

Through the use of a non-pecuniary settlement, the Individual Defendants and plaintiff's counsel are walking away with the lion's share of the benefits (release from the action and attorneys' fees) and the corporation is left with the bill for litigation. Viewing this settlement in the most favorable light, Citigroup and its shareholders will receive no substantial benefit by the corporate governance reforms because there is no mechanism by which to review the impact of the changes or even to hold the Individual directors accountable to implement those changes. All Citigroup and its shareholders are to receive in exchange for corporate therapeutics is the questionable satisfaction of granting broad releases of any and all claims that were or could have been pleaded in favor of a class of officers and directors (the Individual Defendants) that must logically include those who were responsible for what Citigroup suffered in losses.

For these reasons, the Court will not approve this settlement in its present form. As a consequence, the application for attorneys' fees is denied as moot.

Dated: May 14, 2007

FILED
MAY 22 2007
COUNTY CLERK'S OFFICE
NEW YORK

CHARLES E. RAMOS

Counsel are hereby directed to obtain an accurate copy of this Court's opinion from the record room and not to rely on decisions obtained from the internet which have been altered in the scanning process.