

Brown v LaBranche

2007 NY Slip Op 31742(U)

June 15, 2007

Supreme Court, New York County

Docket Number: 0603512/2003

Judge: Helen E. Freedman

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

PRESENT: HELEN E. FREEDMAN
Justice

PART 39

NORMAN and FLORENCE BROWN, derivatively and on behalf of LaBranche & Co.,

INDEX NO. 603512/03

Plaintiffs,

MOTION DATE _____

-v-

MOTION SEQ. NO. 002

GEORGE M.L. LABRANCHE IV., ALFRED O. HAYWARD, JR., ROBERT M. MURPHY, DAVID A. GEORGE, DONALD E. KIERNAN, E. MARGIE FILTER, THOMAS E. DOOLEY, HARVEY S. TRAINSON, S. LAWRENCE PRENDERGAST, JAMES G. GALLAGHER and GEORGE E. ROBB, JR.,

Motion Cal. No. _____

Defendants,

and

LaBRANCHE & CO., INC.

Nominal Defendant.

FILED
JUN 21 2007
COUNTY CLERK'S OFFICE
NEW YORK
PAPERS NUMBERED

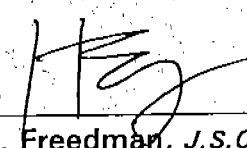
The following papers, numbered 1 to _____ were read on this motion to/for

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 by Plaintiffs is decided in accordance with accompanying memorandum decision.

Dated: June 15, 2007


Helen E. Freedman, J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST

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

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 39

-----X
NORMAN and FLORENCE BROWN, derivatively
and on behalf of LaBranche & Co.,

Plaintiffs,

Index No.
603512/03

-against-

GEORGE M.L. LA BRANCHE IV., ALFRED O.
HAYWARD, JR., ROBERT M. MURPHY, DAVID A.
GEORGE, DONALD E. KIERNAN, E. MARGIE
FILTER, THOMAS E DOOLEY, HARVEY S.
TRAINSON, S. LAWRENCE PRENDERGAST, JAMES
G. GALLAGHER and GEORGE E. ROBB, JR.,

Defendants.

-and-

LABRANCHE & CO., INC.,

Nominal Defendant.

-----X
Freedman, J.

Plaintiffs Norman and Florence Brown move, pursuant to CPLR 3025 (b), for an order granting them leave to file an amended shareholder derivative complaint. Plaintiffs commenced this shareholder derivative action on November 6, 2003, "in the right of and for the benefit of nominal defendant LaBranche & Co. (LaBranche) against the members of its Board of Directors for losses resulting from their alleged breaches of fiduciary duty between April 26, 2000 and October 15, 2003 (the "relevant period")." The Browns purchased shares of LaBranche on September 17, 2003, a month before the end of the relevant period.

LaBranche is a Delaware corporation with its principal offices in New York City. Norman Brown is now deceased. As

Florence Brown (Brown) is now the sole owner of the LaBranche shares formerly jointly owned with her late husband, she is the only named plaintiff in the amended complaint.

On November 3, 2004, this court granted LaBranche's motion to dismiss, on the ground that Brown had not shown that a pre-suit demand on LaBranche's Board of Directors would be futile. The dismissal was without prejudice to her bringing a new action, if such a demand were rejected or were not considered within a reasonable amount of time.

In a January 31, 2005 letter to LaBranche's Board of Directors, Brown demanded that the Board take certain actions with respect to its senior management, as well as its internal audit and reporting mechanisms. In an April 25, 2005 letter, counsel for the Board of Directors informed Brown that the Board had accepted the Audit Committee's recommendation that it reject her demand.

Brown now seeks to file an amended complaint. While CPLR 3025(b) mandates that leave to file an amended pleading be liberally granted, denial is appropriate where a proposed amended complaint is clearly lacking in merit. See e.g. Sharon Ava & Co. v Olympic Tower Assoc., 259 AD2d 315 (1st Dept 1999). Brown asserts that there is no prejudice to the opposing parties, as they have known of her claims since the inception of the lawsuit. She also points out that she complied with the November 3, 2004

order by serving a demand upon LaBranche's Board of Directors and allowing it to respond. Brown states that she needed additional time to assess facts that have emerged from other litigation involving LaBranche, and to determine to what extent developments in those cases might affect her claims.

Brown alleges that defendants permitted improper transactions in connection with LaBranche's role as a "specialist trader" on the New York Stock Exchange (NYSE) and American Stock Exchange, for which the NYSE and the Securities and Exchange Commission (SEC) have levied substantial fines that have heavily affected the value of LaBranche's stock and have resulted in a number of lawsuits against the company.

Brown claims that during the relevant period, defendants failed to disclose that a substantial portion of LaBranche's revenues were derived from violations of its "negative obligation" as a specialist, which requires LaBranche to permit buyers and sellers to execute their buy and sell orders directly, without a specialist's intervention, under certain circumstances. LaBranche and others paid fines for these alleged breaches because they profited by using specialists when they were not needed. The moneys paid in fines and penalties were part of a larger settlement involving four other specialist firms and were accompanied by an administrative order that included "failure to

supervise with respect to certain transactions..." as part of the SEC and NYSE findings.

The gravaman of the initial complaint was that defendants breached their fiduciary duty by failing to properly supervise personnel who were engaged in improper activities and by failing to properly audit firm revenues. The complaint further alleged that LaBranche issued quarterly press releases and filed quarterly statements with the SEC that warned of risks facing LaBranche, and that falsely represented that its disclosure controls were effective. Brown alleged that the statements were false and misleading because they failed to disclose that a material portion of LaBranche's revenues were derived by stepping in to complete trades when the orders could have been executed without intervention. In sum, the complaint alleged poor supervision and lack of oversight by LaBranche's Board of Directors and its Audit Committee.

Defendants oppose the instant motion, arguing that Brown lacks standing to bring this derivative action on two separate grounds: (1) the LaBranche Board of Director's refusal of her demand; and (2) Brown's purchase of her shares of LaBranche stock after the events underlying this suit. Defendants argue that both the demand requirement and the rule that shareholders must hold stock at the time of the wrongdoing alleged in a derivative complaint are prerequisites for maintaining a shareholder's

derivative suit. Alabama By-Products Corp. v Cede & Co., 657 A2d 254 (Del 1995).

A board decision to reject a shareholder demand that it pursue litigation on the corporation's behalf is subject to the deferential "business judgment rule" standard of review. Kamen v Kemper Fin. Servs., Inc., 500 US 90, 101 (1991). The business judgment rule presumes that the directors acted in good faith and on an informed basis. Those presumptions can be rebutted by showing that the directors acted in bad faith or that they breached their fiduciary duty of care or loyalty. In re Walt Disney Co. Derivative Litig. v Eisner, 906 A2d 27, 52 (Del 2006). Defendants argue that the proposed amended complaint does not allege any facts that demonstrate that the business judgment rule presumption does not protect the Board's decision not to institute litigation.

Defendants further maintain that, even if the demand were wrongfully refused, Brown still lacks standing because she was not a LaBranche shareholder during the time the alleged wrongdoing occurred. Defendants point out that all of the allegedly false and misleading press releases and quarterly reports that Brown challenges in her proposed amended complaint pre-date her acquisition of LaBranche shares. Brown became a LaBranche shareholder on September 17, 2003, so that she was a

shareholder for only the final month of the 42 months of the relevant period.

Brown argues that the proposed amended complaint demonstrates that the Board's refusal of her demand was wrongful. She states that three of the defendants were members of the Audit Committee during the period of LaBranche's wrongdoing, and these were the same individuals who were responsible for the rejection of her demand. She states that the entire Board consists of these three directors and the CEO and Executive Vice President, all of whom are named as defendants in this action. Thus, according to Brown, the Board could not have considered her demand disinterestedly and independently.

As to the timing of her purchase of the LaBranche stock, Brown argues that she has standing under the continuing wrong doctrine. She asserts that, while Delaware statutes require that a plaintiff be a shareholder of a corporation at the time of the transaction complained of, the application of these rules becomes complicated in situations such as this one, where allegations include a series of wrongful transactions. She maintains that, even though certain events in a series of transactions transpired before plaintiff became a shareholder, plaintiff may be permitted to maintain the lawsuit. See Bateson v Magna Oil Corp., 414 F2d 128, 130 (5th Cir 1969), cert denied 397 US 911 (1970).

Brown contends, the wrongful transaction continued during the entire time period alleged, and past September 17, 2003, the date that she acquired her stock. Brown maintains that defendants' wrongful conduct first become publicly known on October 16, 2003, that defendants continued the same course of conduct before and after she bought her stock. For that reason, she should be deemed to be a continuous holder who has standing to bring this suit.

In the event that this court finds that Brown does not have standing, she requests the opportunity to amend her proposed amended complaint in order to include, as additional plaintiffs, other shareholders of LaBranche.

According to paragraph 85 of the proposed amended complaint "[t]he full extent of the Defendants' wrongful conduct was not publicly known until October 16, 2003," on which date the NYSE issued a press release announcing its determination to bring disciplinary action against LaBranche and others. The proposed amended complaint also asserts, however, that NYSE and SEC investigations of LaBranche and others were publicly reported and known by mid-April of 2003. Proposed amended complaint, ¶¶ 75-80. LaBranche common stock fell as a result of these disclosures. Id., ¶¶ 75, 77.

The proposed amended complaint also alleges that in the "Legal Proceedings" section of LaBranche's quarterly report for the first quarter of 2003, filed on May 15, 2003, it stated:

On April 22, 2003, the NYSE announced that it was reviewing the trading practices of several specialist firms, including our subsidiary specialist firm, LaBranche & Co. LLC. The investigation presently focuses on the trading requirement that NYSE specialist firms not intervene in a natural match between a buyer and a seller. While we believe that our subsidiary has operated in accordance with all applicable requirements, the investigation is in an early stage and there can be no assurance as to the outcome of the investigation or its effects, if any, on our financial condition.

Proposed amended complaint ¶ 81. Brown alleges that LaBranche misrepresented that it believed that it had not committed any regulatory violations.

Although the NYSE did not announce that it was bringing disciplinary charges until October 16, 2003, it is clear from the allegations in the proposed amended complaint that it was widely and publicly known that SEC and NYSE investigations were under way and that there were allegations of wrongdoing related to LaBranche's violation of its "negative obligation" as a specialist. Brown bought LaBranche stock several months after this information was made public, and she filed her derivative lawsuit a mere three weeks after the NYSE announced its intention to bring a disciplinary action against LaBranche.

The instant motion is denied. Rule 23.1 of the Delaware Chancery Court and section 327 of 8 Delaware General Corporation

Law provide that a derivative plaintiff be a stockholder at the time of the transaction complained of. Schreiber v Bryan, 396 A2d 512, 516 (Del Ch 1978). "A primary purpose of the contemporaneous ownership requirement is to curtail strike suits by prohibiting potential plaintiffs from buying into a lawsuit through the purchase of shares of stock in a corporation after an alleged 'wrong' has occurred." Brambles USA, Inc. v Blocker, 731 F Supp 643, 648 (D Del 1990), citing Newkirk v W.J. Rainey, Inc., 76 A2d 121, 123 (Del Ch 1950).


The alleged wrong was publicly known and widely reported before Brown purchased her stock. The motion before this court is a motion for leave to amend the complaint, not a motion to dismiss the complaint. Brown does not have standing to bring this action, because of the timing of her purchase of stock. The issues concerning the business judgment rule will be deferred to such time as a proper plaintiff is substituted.

Accordingly, it is

ORDERED that the motion to amend the complaint is denied.

Dated: June 15, 2007

ENTER:



Helen E. Freedman, J.S.C.