

**King v Bartlett**

2007 NY Slip Op 34209(U)

December 21, 2007

Supreme Court, New York County

Docket Number: 0600991/2007

Judge: Karla Moskowitz

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SCANNED ON 12/2/2008  
SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY  
PRESENT: Hon. KARLA MOSKOWITZ PART 03  
Justice

-----X  
SAM KING, Derivatively on Behalf of Nominal Defendant  
FLOWERVE CORPORATION,

Plaintiff,

- against -

CHRISTOPHER A. BARTLETT, HUGH K. COBLE, C.  
SCOTT GREER, DIANE C. HARRIS, GEORGE I.  
HAYMAKER, JR., RENEE J HORNBAKER, MICHAEL  
F. JOHNSTON, LEWIS M. KLING, CHARLES M  
RAMPACEK, JAMES O. ROLLANS, WILLIAM C.  
RUSNACK, and KEVIN E. SHEEHAN,

Defendants,

- and -

FLOWERVE CORPORATION,

Nominal Defendant.  
-----X

INDEX NO. 600991/2007

MOTION DATE \_\_\_\_\_

MOTION SEQ. NO. 001

MOTION CAL. NO. \_\_\_\_\_

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 \_\_\_\_\_

PAPERS NUMBERED

**FILED**

JAN 02 2008

Cross-Motion:  Yes  No

NEW YORK  
COUNTY CLERK'S OFFICE

Upon the foregoing papers, It is

ORDERED that this motion is decided in accordance with the accompanying Decision and  
Order.

Dated: December 21 2007

  
\_\_\_\_\_  
KARLA MOSKOWITZ

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:IAS PART 3

-----X  
SAM KING, Derivatively on Behalf of Nominal  
Defendant FLOWSERVE CORPORATION,

Plaintiff,

Index No. 600991/2007

- against -

CHRISTOPHER A. BARTLETT, HUGH K. COBLE,  
C. SCOTT GREER, DIANE C. HARRIS, GEORGE  
I. HAYMAKER, JR., RENEE J HORNBAKER,  
MICHAEL F. JOHNSTON, LEWIS M. KLING,  
CHARLES M RAMPACEK, JAMES O. ROLLANS,  
WILLIAM C. RUSNACK, and KEVIN E. SHEEHAN,

Defendants,

- and -

FLOWSERVE CORPORATION,

Nominal Defendant.

-----X  
**Moskowitz, J.:**

In this derivative action, defendants move, pursuant to CPLR 3211 and 3016, to dismiss the complaint with prejudice for failure to comply with New York Business Corporations Law § 626 (c) and applicable case law.

Plaintiff is a shareholder in nominal defendant Flowserve Corporation (“Flowserve”). He brings this action without previously making a demand on Flowserve’s Board of Directors (“the Board”) to commence a lawsuit. Pursuant to Bus Corp Law § 626 (c), the complaint in a derivative action “shall set forth with particularity the efforts of the plaintiff to secure the initiation of such action by the board or the reasons for not making such effort.” In other words, in order to be excused from making a demand, the plaintiff must show that the a demand would have been futile.

\* 3 ]  
If the shareholder fails to establish futility, the court must dismiss the derivative complaint regardless of the merits of the claims asserted.

There are 11 directors on the Board. Plaintiff does not allege that all 11 directors would be unable to render an impartial determination as to whether or not to commence a lawsuit on behalf of Flowserve. He alleges that six of the 11 directors, comprising a majority of the Board, would not be impartial. Thus, he asserts that a demand would be futile, such that the court should excuse him from making one. At oral argument, the parties agreed that if the court finds plaintiff's argument as to any of the six directors at issue is without merit under the law, then plaintiff's assertion that a majority of the Board would be unable to consider demand would fail, thereby meriting dismissal of the complaint.

Flowserve, a New York corporation, is a manufacturer and aftermarket service provider of comprehensive flow control systems. The 12 defendants in this case are 10 of Flowserve's 11 directors and two of its former officers. Four of the defendants are outside directors who served on Flowserve's Audit/Finance Committee ("the Audit Committee Defendants") and signed its public filings during the complained-of time period.

Defendant Kevin E. Sheehan ("Sheehan") is an outside director who served as Interim Chairman, President and CEO from May 2005 to August 2005, and has been the Chairman of the Board since August 2005. Sheehan signed one of Flowserve's public filings during the complained-of time period. Defendant Lewis M. Kling ("Kling") has served as a director of Flowserve and as its President and CEO since August 1, 2005. Prior to that time, Kling was Flowserve's Chief Operating Officer. Four defendants are outside directors who did not serve on the Audit/Finance Committee and are not alleged to have signed any public filings. Those four

\* 4 ]

directors, along with the four Audit Committee Defendants, Sheehan and Kling, are referred to collectively as the Director Defendants. The remaining two defendants, C. Scott Greer and Renee J. Hornbaker, are former officers of Flowserve (collectively, the Officer Defendants).

Plaintiff asserts three causes of action, each of which is brought against a different group of defendants. The first cause of action, brought against the four Audit Committee Defendants and the Officer Defendants, alleges that they breached their fiduciary duty of good faith during 2000-2004 by ignoring problems with Flowserve's accounting and internal controls. This claim is not asserted against a majority of Flowserve's 11 directors.

The second cause of action, brought against the four Audit Committee Defendants, Sheehan and the Officer Defendants, alleges that they breached their fiduciary duty of good faith during 2000-2004 by knowingly disseminating false and misleading information about Flowserve's financial results. Plaintiff does not assert this claim against a majority of Flowserve's 11 directors, but only against the five directors who are alleged to have signed Flowserve's public filings.

The third cause of action, brought against the two Officer Defendants, alleges unjust enrichment in their receipt of salaries and incentive compensation. Plaintiff does not bring this claim against any of Flowserve's directors.

New York courts are "reluctant to permit shareholder derivative suits" (Marx v Akers, 88 NY2d 189, 194 [1996]) because "[a]s with other questions of corporate policy and management, the decision whether and to what extent to explore and prosecute such [derivative] claims lies within the judgment and control of the corporation's board of directors'." (Id., quoting Auerbach v Bennett, 47 NY2d 619, 631 [1979]).

"Achieving a balance between preserving the discretion of directors to manage a

corporation without undue interference, through the demand requirement, and permitting shareholders to bring claims on behalf of the corporation when it is evident that directors will wrongfully refuse to bring such claims, through the demand futility exception, has been accomplished by various jurisdictions in different ways.” (Id. at 194).

In New York, for demand to be considered futile, the plaintiff is required to plead with particularity that: (a) “a majority of the board of directors is interested in the challenged transaction”; (b) “the board of directors did not fully inform themselves about the challenged transaction to the extent reasonably appropriate under the circumstances”; or (c) “the challenged transaction was so egregious on its face that it could not have been the product of sound business judgment of the directors.” (Id. at 200-01).

Plaintiff focuses on the second of the Marx prongs as to five of the Board members. He maintains that demand was futile as to Sheehan and the four Audit Committee Defendants because they failed to inform themselves adequately about Flowserve’s pervasive accounting and internal control problems. Plaintiff argues that these directors did not make a reasonable, good faith effort to detect and prevent Flowserve’s massive accounting failures.

Plaintiff asserts that demand was futile as to the sixth, Kling, because, under the first prong of the Marx standards for futility, he is “interested” in the underlying transactions at issue. Under New York law, “[d]irector interest may either be self-interest in the transaction at issue, or a loss of independence because a director with no direct interest in a transaction is ‘controlled’ by a self-interested director.” (Marx, 88 NY2d at 200). Plaintiff argues that Kling is interested in the challenged transactions in that he lacks independence because Sheehan and the four Audit Committee Defendants control him.

According to plaintiff, because Kling's principal employment is his position as President and CEO of Flowserve, pursuant to which he receives hundreds of thousands of dollars in salary, bonus and other compensation, there is a reasonable doubt whether Kling could objectively evaluate a demand to pursue plaintiff's claims against the Director Defendants who determine Kling's compensation and whether he will continue to be employed with Flowserve.

Defendants argue that the court should dismiss this case because the demand futility arguments are not pled with particularity, as New York law requires. Defendants also maintain that plaintiff has not pled particular facts showing that a majority of the Board would be unable to consider a demand.

This court finds that the allegations as to Kling's inability independently to consider a demand are insufficient. Therefore, plaintiff cannot meet the futility of demand requirement for a majority of the Board, and defendants are entitled to dismissal of the action. Although "it is well established that a demand will be excused where the alleged wrongdoers control or comprise a majority of the directors" (Barr v Wackman, 36 NY2d 371, 379 [1975]), plaintiff's allegations that the other defendants controlled Kling are not particularized enough to satisfy plaintiff's burden of showing that Kling could not consider demand. "Simply naming a majority of the board as defendants with conclusory allegations of wrongdoing or control is insufficient to circumvent the requirement of demand." (Bansbach v Zinn, 1 NY3d 1, 11 [2003]).

In paragraph 65 (c) of the complaint, plaintiff argues that, because of his position as Flowserve's President and CEO, Kling is "incapable of independently and disinterestedly considering a demand to commence this action against the other Director Defendants, who control his employment and compensation." That Kling is an "inside" director does not, by itself, indicate

\* 7 ]  
that the other five director defendants control him.

Both defendants and plaintiff cite to decisions of cases from around the country in favor of their arguments regarding Kling. Plaintiff, however, does not support his argument that Kling, simply by virtue of his position as CEO and President of Flowserve, is controlled by five of the 11 Board members. One of the most straightforward statements addressing this issue is from the federal court in the Southern District of Texas, that held that:

Plaintiff's claim that the employee directors are not independent from board members, who have the ability to control their employment and compensation, is based solely on their employment positions with [the company] and the compensation that they received for performing the duties of those positions. Demand futility cannot be pleaded merely on the basis of allegations that inside directors would act to preserve their employment positions. If this were the case, every inside director would be disabled from considering a pre-suit demand.

Gutierrez v Logan, 2005 WL 2121554, \*11 (SD Tex, Aug 31, 2005).

Thus, the court grants the motion and dismisses the action. In his memorandum of law in opposition to this motion, plaintiff requests leave to amend if this court grants the motion to dismiss. Defendants argue, however, that the dismissal should be with prejudice, because a federal district court in Dallas previously dismissed plaintiff's claims. Although that dismissal was on jurisdictional grounds and did not address the merits of plaintiff's claims, defendants made the same arguments in opposition to the complaint there as they make here and plaintiff's complaint in this action is the same as the complaint in the Texas action. According to defendants, this indicates that plaintiff cannot add any allegations in an effort to strengthen his claims of demand futility.

Leave to amend should be freely given and thus this court grants such leave. However, the

\* 8 ]  
court notes that defendants have now twice set forth their arguments as to the inadequacy of plaintiff's reasons for not making a demand on the Board. Thus, the court grants defendants' costs in dismissing the complaint.

Accordingly, it is

ORDERED that the motion to dismiss is granted and the complaint is dismissed with leave to replead, and with costs and disbursements to defendants as taxed by the Clerk of the Court; and it is further

ORDERED that the Clerk is directed to enter judgment accordingly.

Dated: December 24, 2007

ENTER:

*[Signature]*  
\_\_\_\_\_  
J.S.C.

**FILED**

JAN 02 2008

NEW YORK  
COUNTY CLERK'S OFFICE