SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NASSAU

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RODGER LOCKRIDGE, Derivatively on Behalf of, Nominal Defendant, PALL CORPORATION,

Plaintiffs,

-against-

ERIC KRASNOFF, LISA MCDERMOTT, DANIEL CARROLL, JR., JOHN HASKELL, JR., KATHERINE PLOURDE, EDWARD TRAVAGLIANTI, JAMES WATSON,

Defendants,

-and-

PALL CORPORATION

Nominal Defendant.

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MICHELE M. WOODARD
J.S.C.
TRIAL/IAS Part 16
Index No.: 17903/07
Motion Seq. No.: 01

DECISION AND ORDER

Papers Read on this Motion:

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Nominal Defendant Pall Corporation (Pall) moves to dismiss the Complaint pursuant to CPLR §3211(a)(7) claiming the Complaint fails to allege facts sufficient to show that a pre-suit demand in accordance with Business Corporation Law § 626(c) would have been futile.

This is a shareholder derivative action brought on behalf of Pall Corporation, a leading manufacturer of filtration, separation and purification devices, against the corporation's chairman and Chief Executive Officer, Eric Krasnoff, Lisa McDermott, Chief Financial Officer (the officer Defendants) and members of the Audit Committee and Corporate Directors: Defendants Daniel

Carroll, Jr., John Haskell, Jr., Katherine Plourde, Edward Travaglianti and James Watson to recover damages arising from their alleged breach of fiduciary duty in failing to make a good faith effort to evaluate the adequacy of Pall's internal controls and accounting and financial reporting systems and failure to evaluate the adequacy of the corporation's compliance with laws and regulations relating to financial reporting and taxation which resulted in a multi-year restatement of Pall's historical financial statements, in excess of $130 million. In the second cause of action Plaintiff alleges that Defendant Krasnoff was unjustly enriched via salaries, bonuses and stock-based compensation based on the corporation's materially overstated financial results.

Plaintiff alleges that Pall's nearly decade long history of GAAP (Generally Accepted Accounting Principles) violations and improper accounting and financial reporting practices, indicates that the Defendants failed to make a good faith effort to evaluate the adequacy of Pall's internal controls and accounting and financial reporting systems and practices, particularly with regard to taxation and/or compliance with laws and regulations relating to financial reporting and taxation. While the Audit Committee was charged with the duty to evaluate, at least quarterly, the adequacy of the Company's financial reporting systems and business process controls; to discuss significant exposures and the actions taken by management to monitor and control such exposures; to meet with management and auditors to review the annual financial statements and related notes prior to filing or public release and to inquire as to whether such financial statements and related notes were prepared in accordance with U.S. Generally Accepted Accounting Principles and consistent with information known to the Committee; Plaintiff alleges that the Audit Committee met only twice in fiscal year 1999 and three times during fiscal year 2000, and during the entire period from 1999-2006 merely rubber stamped the false financial statements prepared by lower-

level managers to Pall's detriment.

Directors and officers of corporations, in the performance of their duties, stand in a fiduciary relationship to their corporation. *Yu Han Young v Chiu*, ___ AD3d ___, 2008 N.Y. Slip Op 01947 [2d Dept 2008]. Generally the actions of directors and majority shareholders of a corporation are protected by the business judgment rule which bars inquiry into the actions of corporate directors which are taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes. *Auerbach v Bennett*, 47 NY2d 619, 629 [1979]; *Owen v Hamilton*, 44 AD3d 452, 456 [1st Dept 2007], *lv to appeal dismissed* 10 NY3d 757 [2008]. Because derivative claims against a corporation's officers and directors belong to the corporation itself, a shareholder bringing a derivative action must first formally demand that the corporation itself take action prior to beginning the suit. Business Corporation Law § 626(c); *Barnsbach v Zinn*, 1 NY3d 1, 8 [2003], *rearg den.* 1 NY3d 593 [2004]. § 626© of the Business Corporation Law provides that the Plaintiff in a shareholder's derivative action "shall set forth with * * * particularity the efforts of the Plaintiff to secure the initiation of such action by the board [of directors] or the reason for not making such effort." The demand requirement rests on basic principles of corporate control, i.e., that the management of the corporation is entrusted to the board of directors who have the primary responsibility for acting in the name of the corporation and are often in a better position to correct alleged abuses without resort to the courts.

The requirement of a demand, however, is excused, if the complaint alleges acts for which a majority of the board of directors may be liable and the Plaintiff has reasonably concluded that the board would not be responsive to a demand, i.e., the demand would be futile. *Marx v Akers*, 88 NY2d 189, 198 [1996]. A demand is futile, and excused, when the directors are incapable of

making an impartial decision as to whether to bring suit. *Danzy v NIA Abstract Corp.*, 40 AD3d 804, 805 [2d Dept 2007]. It is insufficient, however, to merely name a majority of the directors as Defendants while making conclusory allegations of wrongdoing. *Barr v Wackman*, 36 NY2d 371, 379 [1975]; *Glatzer v Grossman*, 47 AD3d 676 [2d Dept 2008]. Rather the complaint must establish with sufficient particularity that a demand would have been futile. *Marx v Akers, supra* at p. 200.

Here, Defendants maintain that the complaint must be dismissed predicated on Plaintiff's failure to satisfy the statutory precommencement condition for bringing a derivative action. Defendants contend, and this court agrees, that Plaintiff failed to allege that the requisite demand for action was made on Pall's Board of Directors and failed to allege with the requisite specificity why such demand would have been futile.

As recognized by both parties, the standard *vis a vis* futility of demand is set out in *Marx v Akers, supra* at 200-201 (citations and internal quotation marks omitted) which holds that demand is futile and excused when directors are incapable of an impartial decision as to whether to bring suit. This occurs when a complaint alleges with particularity that: 1) a majority of the board of directors is interested in the challenged transaction;[1] the board of directors did not fully inform themselves about the challenged transaction to the extent reasonably appropriate under the circumstances; 3) the challenged transaction was so egregious on its face that it could not have been the product of sound judgment of directors. The question of whether the demand requirement of Business Corporation Law § 626(c) has been met is a matter which rests within the sound

[1]Director interest may be either self-interest in the transaction at issue, or a loss of independence because a director with no direct interest in the transaction is controlled by a self-interested director.

discretion of the court. *Mackay v Pierce*, 86 AD2d 655 [2d Dept 1982].

Courts are reluctant to permit shareholder derivative suits because "as 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. *Auerbach v Bennett,* 47 NY2d 619, 631 [1979]. In this case, clearly Plaintiff has failed to plead demand futility with sufficient particularity. As the Court of Appeals emphasized in *Marx*, pre-suit demand is the rule, excusing demand is the exception. The exception should not be permitted to swallow the rule. *Marx v Akers, supra* at p. 200.

Even when accepting the facts alleged in the complaint as true, and according the Plaintiff the benefit of every favorable inference (*Leon v Martinez*, 84 NY2d 83, 87 [1994]), the complaint fails to allege any manner in which the individual Defendants failed, *inter alia*, to exercise reasonable oversight, ignored red flags or other information indicating misconduct which would have alerted them to financial irregularities or illegal scheme, or failed to take specific action that would or could have prevented, alleviated or mitigated the situation. The pleading is devoid of particularized non-conclusory allegations to show the manner in which each of the directors could be characterized as interested and incapable of considering a demand. Interestingly, although the Audit Committee met two times in 1999 and three times in 2000, only two of the Defendants were members of the Audit Committee during those years.[2] Plaintiff does not dispute the fact that the Audit Committee met a total of forty-nine separate times during the period from 1999 to 2006.

With respect to the second cause of action which asserts that Pall officers, Defendants Eric

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[2]Directors Travaglianti, Carroll and Haskell, who joined the Audit Committee after 2000, would be disinterested and able to judge a derivative claim *vis a vis* inadequacy of Committee meetings in 1999 and 2000.

Krasnoff and Lisa McDermott, were unjustly enriched by the salary and benefits they received, the court notes that authority over compensation is vested in the Compensation Committee (none of whose members is alleged to be interested and none of whose members is a Defendant in this action). Moreover, there is no allegation that Defendant Eric Krasnoff (or Lisa McDermott)was involved in the compensation decision nor does the complaint state a particular action that either Defendant took or failed to take in derogation of their respective duties as chairman and chief executive officer and chief financial officer of Pall.

Accordingly, Plaintiff having failed to plead specific individualized allegations as to why each of the Defendant directors was unable to exercise his/her own business judgment in evaluating whether to pursue a derivative claim had a pre-suit demand been made, or that pre-suit demand would have been futile, the complaint must be **dismissed**. The complaint provides no basis to support the proposition that Plaintiff reasonably concluded that the Pall Board of Directors would not have been responsive to a demand.

This constitutes the Decision and Order of the Court.

DATED: April 30, 2008
Mineola, N.Y.

ENTER:

HON. MICHELE M. WOODARD
J.S.C.

ENTERED
MAY 05 2008
NASSAU COUNTY
COUNTY CLERK'S OFFICE

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