

City of Roseville Employees' Retirement Sys. v Dimon
2014 NY Slip Op 33987(U)
December 16, 2014
Supreme Court, New York County
Docket Number: 651011/2012
Judge: Melvin L. Schweitzer
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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: MELVIN L. SCHWEITZER
Justice

PART 45

CITY OF ROSEVILLE EMPLOYEES' RETIREMENT SYSTEM

650294/12
INDEX NO. 650294/2012

-v-

MOTION DATE _____

JAMES DIMON et al

MOTION SEQ. NO. 003

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

Notice of Motion/Order to Show Cause — Affidavits — Exhibits _____ | No(s). _____

Answering Affidavits — Exhibits _____ | No(s). _____

Replying Affidavits _____ | No(s). _____

Upon the foregoing papers, it is ordered that this motion *is by defendant to dismiss the complaint* is GRANTED per the attached Decision and Order.

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

Dated: December 16, 2014

Melvin L. Schweitzer
MELVIN L. SCHWEITZER

1. CHECK ONE: ☒ CASE DISPOSED ☐ NON-FINAL DISPOSITION
2. CHECK AS APPROPRIATE: MOTION IS: ☒ GRANTED ☐ DENIED ☐ GRANTED IN PART ☐ OTHER
3. CHECK IF APPROPRIATE: ☐ SETTLE ORDER ☐ SUBMIT ORDER
- ☐ DO NOT POST ☐ FIDUCIARY APPOINTMENT ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : PART 45

-----X
CITY OF ROSEVILLE EMPLOYEES'
RETIREMENT SYSTEM, Derivatively on
Behalf of JPMORGAN CHASE & CO.,

Plaintiff,

-against-

JAMES DIMON, JAMES S. CROWN,
LABAN P. JACKSON, JR., WILLIAM H.
GRAY, III, ELLEN V. FUTTER, LEE R.
RAYMOND, DAVID C. NOVAK,
STEPHEN B. BURKE, CRANDALL C.
BOWLES, WILLIAM C. WELDON and
DAVID M. COTE,

Defendants,

and

JPMORGAN CASE & CO.,

Nominal Defendant.
-----X

Index No. 651011/2012

DECISION AND ORDER

Motion Sequence No. 003

MELVIN L. SCHWEITZER, J.:

In this action, City of Roseville Employees' Retirement System (City of Roseville) brings a shareholder derivative claim for the breach of the fiduciary duty of loyalty and for the waste of corporate assets against eleven individual defendants who are current or former members of the Board of Directors of JPMorgan Chase & Co. (Director Defendants), as well as against nominal defendant JP Morgan Chase & Co. (JPMorgan, and together, defendants). Defendants have moved to dismiss the complaint pursuant to CPLR 3211 (a) (7) for failure to state a cause of action and Del. Ch. Ct. R. 23.1 for City of Roseville's failure to make a pre-litigation demand on the Board.

Background

The following facts are taken from the Verified Second Amended Stockholder Derivative Complaint.

City of Roseville has been a shareholder of JPMorgan continuously since 2008.

JPMorgan is a major provider of financial services. It has its principal executive offices in New York and is incorporated in Delaware.

Individual defendants James Dimon, Crandall C. Bowles, Stephen B. Burke, James S. Crown, Laban P. Jackson, Jr., Lee R. Raymond, and William C. Weldon are current members of the JPMorgan Board of Directors. James Dimon has served as Chairman of the Board of JPMorgan since 2006, and as CEO and President since 2005. Individual defendants David M. Cote, Ellen v. Futter, William H. Gray, III, and David C. Novak are former members of the JPMorgan Board of Directors.

The complaint alleges that JPMorgan's Mortgage Loan Servicing Department engaged in a variety of illegal activities between 2008 and 2010 and, as early as 2008, the JPMorgan Board of Directors had actual knowledge of these violations. On March 30, 2008, Nye Lavalley, a JPMorgan stockholder, sent an email to fraud.prevention.and.investigation@jpmchase.com, an email address which a JPMorgan document entitled "Corporate Governance Principles of the Board" instructed stockholders to use if they wished to communicate with the JPMorgan Board of Directors. According to City of Roseville, Mr. Lavalley sent the email to (i) inform the Board that the JPMorgan Mortgage Loan Servicing Department was engaged in a wide variety of illegal activities in connection with JPMorgan's mortgage loan foreclosure processes and practices, (ii) ask the Board to undertake an investigation into these illegal acts, and (iii) ask the Board to prevent the Mortgage Loan Servicing Department from engaging in this illegal activity.

The email also contained a report from Mr. Lavallo, which allegedly described in detail the illegal activities that the Mortgage Loan Servicing Department was engaging in. Mr. Lavallo also attached a New York Times article reiterating the points he made in his report.

Mr. Lavallo sent two further emails to the JPMorgan board via the same email address, one in February 2009 and one in December 2009. Attached to the February email was an article entitled, "Where's the Note, Who's the Holder: Enforcement of Promissory Note Secured by Real Estate," authored by the Hon. Samuel L. Bufford, U.S. Bankruptcy Judge for the Central District of California. According to the article, a number of foreclosure cases "illustrate enormous problems in the loan servicing industry." Attached to the December email was a PowerPoint presentation authored by David Weichel, entitled "The Problem of Foreclosure Titles in NSP Acquisitions," which also addressed alleged wrongdoings by JPMorgan's Mortgage Loan Servicing Department. According to City of Roseville, the emails Mr. Lavallo sent as well as the various attachments to those emails provided the Board of Directors with actual knowledge of illegal conduct, the disregard of which constituted a breach of Director Defendants' fiduciary duties.

City of Roseville further alleges that the JPMorgan Board of Directors obtained actual knowledge that JPMorgan's Loan Servicing Department was engaged in illegal acts as a result of several high-profile lawsuits. Specifically, City of Roseville lists *In re Schussler*, No. 07-35608 (Bankr. SDNY April 10, 2008), *In re Nuer*, No. 08-14106 (Bankr. SDNY filed Oct. 10, 2008), *Woodruff v Chase Home Finance, LLC*, No. 02-81159, 2010 Bankr. LEXIS 312 (Bankr. MD Ala. Jan. 27, 2010), and *Canty v. Chase Home Finance, LLC*, No. 09-700029, 2010 Bankr. LEXIS 1519 (Bankr. ND Ala. May 7, 2010) as examples of litigation in which JPMorgan has been sanctioned by courts for "routinely fil[ing] false affidavits and documentation in

Bankruptcy courts across the United States.” As a result of such sanctions, the Director Defendants were “provided with *actual* knowledge that the Bank systematically violated the United States Bankruptcy Code and Federal False Claims Act during the 2008–2010 period.”

As a result of having committed the acts detailed in the complaint, City of Roseville alleges that JPMorgan became the subject of investigations by a number of state attorneys general, the OCC, the U.S. Senate Committee on Banking, Housing, and Urban Affairs, and the FBI. The resolution of these investigations has caused JPMorgan to incur an aggregate of over \$7 billion in damages.

City of Roseville filed a shareholder derivative suit against defendants seeking an accounting for all damages sustained by JPMorgan as a result of the illegal acts its Loan Servicing Department engaged in between 2008 and 2010. City of Roseville requests that Director Defendants pay damages to JPMorgan and that the employment of Mr. Dimon be terminated.

Procedural History

The initial complaint in this action was filed on January 31, 2012. On July 12, 2012, this Court held that the initial complaint “fail[ed] to allege facts with respect to the futility of the pre-litigation demand on the board,” and granted defendants’ motion to dismiss for failure to make a pre-litigation demand. The court granted City of Roseville the opportunity to file an amended pleading. Pursuant to a stipulation entered into by the parties on April 1, 2014, City of Roseville has filed a Second Amended Stockholder Derivative Complaint.

Discussion

On a motion to dismiss for failure to state a claim, the court accepts all factual allegations pleaded in plaintiff’s complaint as true and gives plaintiff the benefit of every favorable

inference. CPLR 3211 (a) (7); *Sheila C. v Povich*, 11 AD3d 120 (1st Dept 2004). The court must determine whether “from the [complaint’s] four corners[,] ‘factual allegations are discerned which taken together manifest any cause of action cognizable at law.’” *Gorelik v Mount Sinai Hosp. Ctr.*, 19 AD3d 319, 319 (1st Dept 2005) (quoting *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 (1977)). Vague and conclusory allegations, however, are not sufficient to sustain a cause of action. *Fowler v American Lawyer Media, Inc.*, 306 AD2d 113 (1st Dept 2003).

Under Delaware law, “the right of a stockholder to prosecute a derivative suit is limited to situations where either the stockholder has demanded the directors pursue a corporate claim and the directors have wrongfully refused to do so, or where demand is excused because the directors are incapable of making an impartial decision regarding whether to institute such litigation.” *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A2d 362, 366-367 (Del. 2006); see *Aronson v Lewis*, 473 A2d 805, 811 (Del. 1984). The standard for alleging demand futility is strict: allegations of demand futility must “comply with ‘stringent requirements of factual particularity’ and set forth ‘particularized factual statements that are essential to the claim.’” *In re Citigroup Inc. Shareholder Derivative Litigation*, 964 A3d 106, 120-121 (Del. Ch. 2009) (quoting *Brehm v Eisner*, 746 A2d 244, 254 (Del. 2000)).

Aronson v Lewis set forth the traditional test for whether demand is futile and, therefore, excused: “the Court . . . must decide whether, under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment.” 473 A2d at 814 (Del. 1984). Under the first prong of the *Aronson* test, the demand futility analysis must proceed “director-by-director and transaction-by-transaction” in order to be pled with particularity. *Khanna v McMinn*, 2006 WL 1388744, *14 (Del. Ch. May 9, 2006, No. Civ. A. 20545-NC).

Rales v Blasland further stipulates that, in cases where plaintiff challenges a board's *inaction*, plaintiff must allege particularized facts to raise a reasonable doubt that at least half of the members of the board could have exercised reasonable and independent judgment when responding to the demand. 634 A2d 927, 934 (Del. 1993). "That is, [in case of board inaction], the Court will apply only the first ('disinterest' and 'independence') prong of *Aronson*." *In re Bally's Grand Deriv. Litig.*, No. 14644, 1997 WL 305803, at *3 (Del. Ch. June 4, 1997).

City of Roseville does not attempt to allege that the Director Defendants were not independent. Rather, City of Roseville relies on the contention that the Director Defendants were not disinterested in the alleged transactions. To allege lack of disinterest, a plaintiff must plead with particularity facts that establish a "substantial likelihood" of Director Defendants' personal liability for the alleged *intentional* misconduct. *Rales*, 634 A2d at 936. "Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith." *Stone*, 911 A2d at 370. In order to demonstrate lack of director disinterest and demand futility, City of Roseville must thus allege with particularity such a "sustained or systematic failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system exists" that demonstrates a lack of good faith on the part of defendants. *In re Caremark Int'l Inc. Derivative Litig.*, 698 A2d 959, 971 (Del. Ch. 1996).

City of Roseville fails to plead particularized facts which would establish lack of good faith and thus a breach of the fiduciary duty of loyalty on the part of Director Defendants. City of Roseville relies on two incidents to demonstrate that JPMorgan's directors "possessed direct knowledge of such illegal practices" by the Loan Servicing Department. The first is a series of

email messages and attachments sent to an email address, fraud.prevention.and.investigation@jpmchase.com, communications to which address City of Roseville alleges the Audit Committee “was required to, and did, report to JPM/Chase’s entire Board.” Despite this cursory allegation, City of Roseville provides no facts which demonstrate that either the Audit Committee or the individual directors actually received these email messages. City of Roseville’s argument that the Audit Committee reported “all of the email communications received via [that] e-mail address” to the Board is unconvincing, since a large corporation such as JPMorgan surely receives a multitude of emails from concerned or disgruntled shareholders on a regular basis. City of Roseville does not allege facts which demonstrate, and it is frankly quite unlikely, that all such emails are brought to the Board’s attention. In fact, City of Roseville was provided access to the meeting minutes of the JPMorgan Board of Directors; however, it tellingly does not reference the board minutes in the complaint to demonstrate that Board of Directors actually discussed Mr. Lavalley’s emails or any other such emails received at the given email address. City of Roseville’s allegations regarding Mr. Lavalley’s emails thus do not fulfill the “stringent requirements of factual particularity” necessary to demonstrate demand futility. *Brehm*, 746 A2d at 254.

Similarly, City of Roseville discusses in its complaint four bankruptcy proceedings that JPMorgan was engaged in during and following the financial crisis, and conclusorily notes that they were “high-profile” enough that the Board must have gained actual knowledge of the mortgage department’s wrongdoings. However, City of Roseville fails to allege facts demonstrating that the Board had such knowledge about these particular sanctions. Banks like JPMorgan are often engaged in hundreds of litigations and foreclosure proceedings at a time. Despite JPMorgan being sanctioned in a several of these proceedings, there is nothing in the

complaint that establishes that JPMorgan's Board of Directors became aware of these specific proceedings or the content of the related sanctions. City of Roseville's assertions that the proceedings constituted "legal matters that may have a material impact on the corporation's financial statements" and that "the Audit Committee was required to, and did, provide reports to JPM/Chase's entire Board concerning the allegations" are not backed up by any particularized facts and, again, do not reference the meeting minutes of the Board of the Directors, which City of Roseville had access to. City of Roseville has failed to allege particularized facts that Directors had actual knowledge of the bankruptcy proceedings or accompanying sanctions against the Mortgage Loan Servicing Department of JPMorgan.

Based on the foregoing, City of Roseville has failed to demonstrate a lack of disinterest on the part of Director Defendants or a corresponding breach of the duty of loyalty. It has made no particularized allegations of "actual knowledge" on the part of the Board and thus has not demonstrated that Director Defendants "fail[ed] to act in the face of a *known* duty to act, thereby demonstrating a conscious disregard for their responsibilities," *Stone*, 911 A3d at 370. At best, City of Roseville has alleged a duty of care case, since the presence of accusatory emails and sanctions in bankruptcy proceedings may have been red flags for the Board of Directors regarding wrongdoing in the Mortgage Loan Servicing Department. However, JPMorgan contains a section 102(b)(7) exculpatory clause in its Charter, eliminating the personal liability of Director Defendants to the corporation for monetary damages for breach of the duty of care.

City of Roseville has also not been able to show a "sustained or systematic failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system exists," *In re Caremark*, 698 A3d at 971, since the complaint itself demonstrates that a system of checks was in place. The email address used by Mr. Lavalle

allowed shareholders to address complaints to the Audit Committee. Furthermore, as City of Roseville noted in the complaint, the Audit Committee is charged with “review[ing] with management the corporation’s program for compliance with laws and regulations and review[ing] the record of such compliance; and review[ing] significant legal cases outstanding against the corporation or its subsidiaries and other regulatory or legal matters.” Thus, even if the specific emails or bankruptcy proceedings discussed by City of Roseville never came to the attention of the Board of Directors, JPMorgan clearly has in place a system of reporting and board oversight. City of Roseville has failed to allege that Director Defendants did not act in good faith, thus breaching their duty of loyalty.

Because the complaint does not create a reasonable doubt with respect to directors’ disinterestedness and fails the *Aronson/Rales* test, the court grants defendants’ motion to dismiss for failure to make a pre-litigation demand.

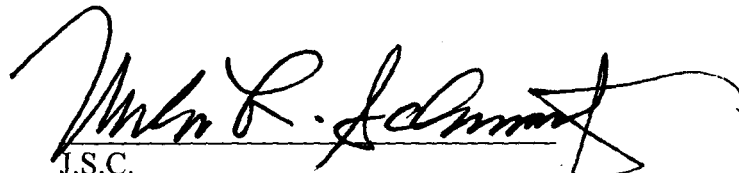
City of Roseville has also failed to provide a basis for excusing demand due to corporate waste. A claim against a director for waste arises only where a Board of Director authorizes action “on terms that no person of ordinary, sound business judgment could conclude represents a fair exchange.” *Steiner v Meyerson*, No. 13139, 1995 WL 441999, at *1 (Del. Ch. July 19, 1995). “[W]aste is a rare, ‘unconscionable case[] where directors irrationally squander or give away corporate assets.’” *In re Walt Disney Co. Deriv. Litig.*, 907 A2d 693, 748-49 (Del. Ch. 2005) (quoting *Brehm*, 746 A2d at 263). City of Roseville certainly does not allege any facts demonstrating that the Board has made any affirmative actions involving “squander[ing] . . . corporate assets” or failing to make a “fair exchange.” Rather, City of Roseville alleges merely Board inaction in light of potential misdoings by the Mortgage Loan Servicing Department.

Because these allegations are merely conclusory, the second claim for corporate waste is dismissed.

ORDERED that defendants' motion to dismiss plaintiff's first and second causes of action is granted.

Dated: December 16, 2014

ENTER:


J.S.C.
MELVIN L. SCHWEITZER