IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE CITIGROUP INC. SHAREHOLDER DERIVATIVE LITIGATION	CONSOLIDATED C.A. NO. 3338-CC

DEFENDANTS' OPENING BRIEF IN SUPPORT OF THEIR MOTION TO DISMISS OR STAY THIS ACTION OR, IN THE ALTERNATIVE, TO DISMISS THE CONSOLIDATED SECOND AMENDED DERIVATIVE COMPLAINT

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Dated: December 4, 2008

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PRELIMINARY STATEMENT

This derivative action arises from the unprecedented credit crisis that swept across the United States economy in 2007, creating turmoil in the markets. It consolidates derivative claims that four different shareholders filed soon after Citigroup announced losses on subprime-related exposures in the second half of 2007.

Parallel shareholder derivative actions—likewise purportedly commenced on behalf of Citigroup, asserting substantially the same claims, against substantially the same defendants, on the basis of the same operative facts—have now been consolidated in the United States District Court for the Southern District of New York. That consolidated derivative action is one of three consolidated Citigroup subprime cases now pending in that court before the Honorable Sidney H. Stein. The other two involve putative class actions alleging securities fraud and violations of ERISA. Lead plaintiffs and lead counsel have been appointed in each consolidated action and Judge Stein has entered scheduling orders that call for briefing of motions to dismiss over the next several weeks. Because the federal derivative action includes a claim that can only be adjudicated in federal court, and because New York is the center of gravity for the events at issue, the consolidated proceeding in this Court should either be dismissed or stayed in favor of the parallel and earlier-filed derivative actions pending in New York.

In the alternative, this Court should dismiss Plaintiffs' Complaint under Court of Chancery Rule 23.1 for failure to make a pre-suit demand upon Citigroup's Board of Directors, and because the Complaint does not meet the stringent pleading requirements necessary for demand futility. Plaintiffs fail to plead *with particularity* facts establishing that a majority of the directors were incapable of exercising their business judgment with respect to a demand, had one been made.

The independence of a majority of Citigroup's Board is not in dispute here. Plaintiffs instead argue that the directors could not consider a demand because they face a substantial likelihood of liability for allegedly ignoring warning signs about conditions in the housing and subprime markets, failing to prevent the company from taking subprime-related assets onto its books, allowing the company to issue allegedly improper public disclosures about its exposure to those assets, and failing to halt a repurchase of Citigroup stock while those exposures existed. (¶¶ 73–77, 174–178, 193–95.)[1] However, none of Plaintiffs' allegations in fact raises a substantial likelihood of personal liability. Conspicuously absent from the Complaint is *any* well-pleaded allegation of bad faith by the directors, or *any* allegation that specific problems within the Company were brought to the Board's attention but ignored. Indeed, Plaintiffs have conceded that the Board had oversight processes in place—including an audit committee comprised entirely of outside directors, which met regularly throughout the relevant period and discussed the risks in the subprime market. Moreover, Citigroup's certificate of incorporation explicitly exculpates the directors for breach of fiduciary duty claims where the directors have acted in good faith.

Lastly, the Complaint should be dismissed under Court of Chancery Rule 12(b)(6) for failure to state a claim upon which relief may be granted.[2] For many of the same reasons that defeat Plaintiffs' attempt to plead demand futility, Plaintiffs also fail to plead adequately claims for breach of fiduciary duty, waste and mismanagement.

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[1] Citations in the form of "¶ __" refer to paragraphs in the Consolidated Second Amended Derivative Complaint (the "Complaint"). Citations in the form of "Ex. __" refer to exhibits attached to the Declaration of John D. Hendershot in Support of Defendants' Motion to Dismiss or Stay this Action or, in the Alternative, to Dismiss the Consolidated Second Amended Derivative Complaint.

[2] Nominal defendant Citigroup Inc. does not join in the arguments for dismissal pursuant to Court of Chancery Rule 12(b)(6).

* * *

There is no dispute that Citigroup has lived through an unprecedented period of dislocation in the credit and housing markets, which has had severe, sometimes catastrophic, effects on firms across the financial services industry. But difficult times do not give shareholders the right to usurp board authority. If there are any claims for Citigroup to pursue here, Plaintiffs have made no particularized allegations to raise any doubt about the ability of Citigroup's Board to act in good faith in considering them.

STATEMENT OF FACTS

I. Procedural Background

In late 2007, an unprecedented credit crisis swept across the United States economy, causing severe dislocations in the market. As a result of the crisis, nearly every bank on Wall Street announced substantial write-downs of subprime-related assets. Shareholder plaintiffs responded immediately with a deluge of litigation.[3]

Like other banks, Citigroup is facing an onslaught of litigation relating to its subprime-related write-downs in late 2007. On November 4, 2007, Citigroup announced an estimated $8 to $11 billion write-down for the fourth quarter. Within days, the first of four securities fraud actions was filed, the first of fourteen ERISA actions was filed, and the first of eleven shareholder derivative actions was filed relating to Citigroup subprime mortgage-related exposure. All of the securities fraud actions and ERISA actions were filed in the federal district court for the Southern District of New York, and were consolidated by the Honorable Sidney H. Stein as *In re Citigroup Inc. Securities Litigation*, No. 07 Civ. 9901 (SHS), and *In re Citigroup, Inc. ERISA Litigation*, No. 07 Civ. 9790 (SHS), respectively. Lead plaintiff and lead counsel were appointed in those actions, consolidated class action complaints have been filed,[4] and briefing on motions to dismiss is currently underway. Additionally, two actions asserting claims under the 1933 Act were filed in New York state court recently. Those actions were removed

[3] *See, e.g., In re Merrill Lynch & Co., Inc. Sec., Derivative & ERISA Litig.*, No. 07 Civ. 9633 (S.D.N.Y. Oct. 30, 2007) (consolidating and then coordinating five securities actions, three derivative actions, and eleven ERISA actions against Merrill Lynch); *In re UBS AG Sec. Litig.*, No. 07 Civ. 11225 (S.D.N.Y. Dec. 13, 2007) (consolidating two securities actions against UBS); *Clark v. Sullivan, et al.*, No. 07 Civ. 10464 (S.D.N.Y. Nov. 20, 2007) (consolidating two derivative suits against Credit Suisse).

[4] The consolidated class action complaint in the securities fraud action is 500 pages long with over 1000 numbered paragraphs.

and are now pending in the Southern District of New York as well. *Louisiana Sheriffs' Pension and Relief Fund, et al. v. Citigroup Inc., et al.*, No. 08 Civ. 9522 (S.D.N.Y.); *Minneapolis Firefighters' Relief Association, et al. v. Rosen, et al.*, No. 08 Civ. 10353 (S.D.N.Y.).

Of the eleven derivative actions filed against Citigroup, five actions were filed in the Southern District of New York, four actions were filed in this Court, and two actions were filed in New York state court.[5] None of the derivative complaints was preceded by a demand upon Citigroup's Board.

On August 22, 2008, the five derivative actions pending in the Southern District of New York were consolidated by the Honorable Sidney H. Stein as *In re Citigroup, Inc. Shareholder Derivative Litigation*, No 07 Civ. 9841, and interim lead counsel was appointed. On November 10, 2008, a Verified Consolidated Derivative Action Complaint was filed in that action, alleging (1) violation of the Exchange Act § 10(b) and Rule 10b-5 (derivatively on behalf of Citigroup), (2) breach of fiduciary duties of care, loyalty and good faith, (3) breach of fiduciary duty for insider trading and misappropriation of information, (4) breach of fiduciary duty of disclosure, (5) waste of corporate assets, and (6) unjust enrichment. (Ex. 35 at 60–65.)

On February 5, 2008, this Court consolidated the four actions before it under the caption *In re Citigroup Inc. Shareholder Derivative Litigation*, and appointed plaintiffs Montgomery County Employees' Retirement Fund, City of New Orleans Employees' Retirement System, Sheldon M. Pekin Irrevocable Descendants Trust Dated 10/01/01, and Carole Kops (collectively, "Plaintiffs") as lead plaintiffs. On February 19, 2008, Plaintiffs filed their Consolidated Amended Derivative Complaint. On April 21, 2008, Defendants moved to dismiss

[5] The derivative actions filed in New York state court have not proceeded. Counsel for plaintiffs in those actions announced their intention to file an amended complaint, but have not yet done so.

the Consolidated Amended Derivative Complaint under Court of Chancery Rule 23.1 for failure to make a pre-suit demand and under Court of Chancery Rule 12(b)(6) for failure to state a claim on which relief could be granted, and filed their opening brief in support of the motion. Rather than oppose Defendants' motion to dismiss, on August 21, 2008, Plaintiffs moved for leave to file a further amended complaint.

On September 15, 2008, the parties stipulated to the filing of the Consolidated Second Amended Derivative Complaint. In the new Complaint, Plaintiffs assert four claims: (1) breach of fiduciary duty (¶¶ 200–06); (2) breach of fiduciary duty of disclosure (¶¶ 207–10); (3) waste (¶¶ 211–18); and (4) reckless and gross mismanagement (¶¶ 219–25). Plaintiffs did not make a demand upon the Board of Citigroup prior to instituting this action in the Company's name.

In contrast to the eleven shareholders who have filed derivative suits alleging demand futility, two shareholders have sent letters to the Citigroup Board urging them to pursue claims of the type that plaintiffs allege in this case. A committee of the Board has been formed to consider those demands with the assistance of separate counsel. Another shareholder has invoked Section 220 of the General Corporation Law and asked to examine Citigroup documents pertaining to the Company's subprime-related losses, the agreement with Mr. Prince, and other matters.

II. Citigroup's Board of Directors

Citigroup is a global financial services company organized and existing under the laws of Delaware with its principal place of business in New York City, New York. (¶ 14.) As of November 9, 2007, when the first of Plaintiffs' now-consolidated derivative actions was

filed,[6] the following thirteen individuals served on Citigroup's Board of Directors: C. Michael Armstrong, Alain J.P. Belda, George David, Kenneth T. Derr, John M. Deutch, Andrew N. Liveris, Anne M. Mulcahy, Richard D. Parsons, Roberto Hernández Ramirez, Judith Rodin, Robert E. Rubin, Robert L. Ryan, and Franklin A. Thomas (collectively, the "November 2007 Directors"). (¶¶ 15–27.) The November 2007 Directors are prominent business and academic leaders:

- *C. Michael Armstrong* is the Chairman of the Board of Trustees of Johns Hopkins Medicine, Health Systems and Hospital. Armstrong previously served as CEO and Chairman of AT&T Corp. and Hughes Electronic Corporation, and as Chairman of Comcast Corporation. (Ex. 1 at 18.)

- *Alain J.P. Belda* is the Chairman and CEO of Alcoa, Inc. He serves as co-Chair of the Brazil Project Advisory Board at the Woodrow Wilson International Center for Scholars. (*Id*. at 19.)

- *George David* is the Chairman and CEO of United Technologies Corporation. He is a director of BP P.L.C., where he serves as a member of the Chairman's Committee and the Audit Committee, and Vice Chairman of the Institute for International Economics. He was awarded the Order of Friendship from the Russian Federation in 1999 and admitted to the French Legion d'Honneur in 2002. (Ex. 2.)

- *Kenneth T. Derr* is the retired Chairman of Chevron Corporation. He is also a director of Calpine Corporation and Halliburton Company. He is a trustee emeritus of Cornell University and a director of the University of California at San Francisco Foundation. (Ex. 1 at 20.)

- *John M. Deutch* is an Institute Professor at the Massachusetts Institute of Technology and the former Director of Central Intelligence, and the former Deputy Secretary of the U.S. Department of Defense. He is a director of Raytheon Company and a trustee of Resources for the Future and the Museum of Fine Arts, Boston. (*Id*.)

- *Andrew N. Liveris* is the President, CEO, and Chairman of Dow Chemical Company. He is a trustee of the Herbert H. and Grace A. Dow Foundation and Tufts University. (*Id*. at 22.)

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[6] Futility is gauged by the circumstances existing at the commencement of a derivative suit. *See, e.g.*, *Aronson v. Lewis*, 473 A.2d 805, 810 (Del. 1984), *overruled on other grounds sub nom. Brehm v. Eisner*, 746 A.2d 244 (Del. 2000); *Harris v. Carter*, 582 A.2d 222, 228–29 (Del. Ch. 1990).

- *Anne M. Mulcahy* is the Chairman and CEO of Xerox Corporation. She is also a director of Target Corporation and the Washington Post Company. (*Id.* at 23.)

- *Richard D. Parsons* is the Chairman of Time Warner Inc., where he previously served as CEO. He is the Chairman of the Apollo Theatre Foundation and a trustee of the Museum of Modern Art, Howard University and the American Museum of Natural History. (*Id.*)

- *Roberto Hernández Ramirez* is the Chairman of Banco Naçional de Mexico, S. A., where he previously served as CEO. He is a member of the International Advisory Committee of the Federal Reserve Bank of New York and a director of the David Rockefeller Center for Latin American Studies at Harvard. (*Id.* at 21.)

- *Judith Rodin* is the President of the Rockefeller Foundation. She previously served as President of the University of Pennsylvania and Provost of Yale University. She is a director of the World Trade Memorial Foundation and Carnegie Hall. (*Id.* at 24.)

- *Robert E. Rubin* became Chairman of Citigroup on November 4, 2007 and later left that position in December 2007. He is the former Secretary of the Treasury of the United States and co-Senior Partner and co-Chairman of Goldman, Sachs & Co. He is also a member of The Harvard Corporation and co-Chairman of The Council on Foreign Relations. (*Id.*)

- *Robert L. Ryan* is the retired CFO of Medtronic, Inc., and the former CFO of Union Texas Petroleum Corp. He is a trustee of Cornell University and a member of the Visiting Committee of Harvard Business School. He also serves on the boards of The Black & Decker Corp., General Mills, Inc., Hewlett-Packard Co. and UnitedHealth Group Inc. (*Id.* at 25.)

- *Franklin A. Thomas* is a consultant to The Study Group. He previously served as President of The Ford Foundation and Chairman of the September 11th Fund. (*Id.*)

Of these thirteen directors on the Board in November 2007, only Robert Rubin was employed by Citigroup other than as an outside director. (¶ 25; Ex. 1 at 24.) Rubin and Roberto Hernández Ramirez are the only two board members who Plaintiffs allege are not independent. (*See* ¶¶ 181–82.) Plaintiffs thus concede the independence of eleven of the thirteen directors.

III. The Subprime Mortgage Crisis

In 2006 and early 2007, Plaintiffs allege, the United States real estate "bubble" burst—housing prices dropped, interest rates rose, subprime[7] mortgage delinquency rates increased, and several mortgage originators filed for bankruptcy. (¶¶ 73, 74.) Notwithstanding these events, market regulators and participants viewed the impact of the subprime mortgage market's decline as limited.

- In March 2007, Federal Reserve Director of Banking Supervision and Regulation Roger T. Cole stated that: "at this time, ***we are not observing spillover effects from the problems in the subprime market to traditional mortgage portfolios or, more generally, to the safety and soundness of the banking system***." (Ex. 3 at 1.)

- In March 2007, Federal Reserve Chairman Ben Bernanke stated that "***the impact on the broader economy and financial markets of the problems in the subprime market seem likely to be contained***." (Ex. 4 at 1–2.)

- In May 2007, Federal Reserve Chairman Ben Bernanke stated that "***the effect of the troubles in the subprime sector on the broader housing market will likely be limited***, and we do not expect significant spillovers from the subprime market to the rest of the economy or the financial system." (Ex. 5 at 6.)

- In July 2007, Treasury Secretary Henry Paulson stated that he believed that ***the housing market correction was "at or near the bottom"*** and that ***the financial markets remained generally healthy***. (Ex. 6.)[8]

- In July 2007, Federal Reserve Chairman Ben Bernanke stated that "[o]verall, ***the U.S. economy appears likely to expand at a moderate pace*** over the second half of 2007, with growth then strengthening a bit in 2008 to a rate close to the economy's underlying trend." (Ex. 9 at 2.)

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[7] "Subprime" generally refers to borrowers who do not qualify for prime interest rates, typically due to weak credit histories, low credit scores, high debt-burden ratios or high loan-to-value ratios. (¶ 65.)

[8] *See also* Bd. of Governors of the Fed. Reserve Sys., *Monetary Policy Report to the Congress*, at 22 (July 18, 2007) ("[Subprime] pressures have been contained") (Ex. 7); Special Comment by Moody's: *Update on Sub-Prime and Related Exposures at US Investment and Commercial Banks*, at 2 (Aug. 2007) ("[T]here are currently no negative rating implications for the [major US investment banks, including Citigroup] as a result of their involvement in the sub-prime sector.") (Ex. 8).

- In July 2007, Treasury Secretary Henry Paulson stated "***I think we're at or near the bottom there***. I don't deny there's a problem with subprime mortgages but I really do believe it's containable, it's quite containable." (Ex. 10 at 1.)

However, in mid-August 2007, an unprecedented credit crisis struck the worldwide economy. (*See* Ex. 42.) Credit markets froze, liquidity dried up, the commercial paper market collapsed, and interbank lending rates rose dramatically. (*See* Ex. 11.) Mortgage delinquencies continued to rise and became more common among borrowers in the category just above subprime. (¶ 74.) Investors began to pull away from mortgage debt, including bonds and other securities backed by home loans. (*Id.*)

As a result of the severe dislocations in the credit markets and the sudden decline in the value of mortgage-backed securities, Citigroup—like almost every other bank on Wall Street—reported disappointing results in the second half of 2007, including multi-billion dollar write-downs on exposures in the investment bank to subprime mortgages. (*See* ¶¶ 74, 104, 108, 115.) The vast majority of these write-downs related to holdings in super-senior tranches of collateralized debt obligations ("CDOs").[9]

[9] A CDO is an asset-backed security constructed from a portfolio of fixed-income assets including residential mortgage based securities ("RMBS"). (¶ 66.) The rights to the cash flow from the assets are divided into a number of classes, or "tranches," whereby the senior tranches receive payment before the junior tranches. (*Id.*) Losses are applied in reverse order of seniority and so junior tranches offer higher coupons (interest rates) to compensate for the added default risk. (*Id.*) Each tranche is rated by independent ratings firms according to the perceived credit risks. (*Id*.) The senior tranche is typically rated AAA (the highest of the 10 investment-grade ratings and the rating of government debt). (¶ 74.) Above the senior tranche, CDOs often have an unrated "super-senior" tranche. Because the super-senior tranche has priority of payment ahead of the senior tranche, it is regarded as having an above-AAA rating. *See* Douglas J. Lucas, Laurie S. Goodman & Frank J. Fabozzi, *Collateralized Debt Obligations: Structures and Analysis* 236 (2d ed. 2006) ("The super senior AAA tranche is senior to a tranche that is also rated AAA, so the super senior's credit risk can be considered to be even better than AAA.").

IV. Write-Downs Across the Financial Industry

On October 1, 2007, Citigroup "pre-announced" its expectation that third quarter results would be adversely impacted by the dislocations in the mortgage-backed securities and credit markets. (¶ 104.) On October 15, 2007, Citigroup reported that it would write down $1.35 billion on the value of leveraged loans and $1.56 billion on subprime-related assets in Citigroup's structured credit products business, including CDOs that Citigroup assembled for sale to institutional investors. (¶¶ 108–09.)

The credit markets continued to seize up throughout October 2007. In mid- to late-October, the credit ratings agencies cut ratings on $23.35 billion of securities backed by residential mortgages, including a significant number of the highest-rated securities. (¶ 74.) These rating agency moves were anticipated to result in additional significant downgrades on highly-rated CDO tranches.[10] (Ex. 12.)

As a result of these unprecedented late-October downgrades, on November 4, 2007, Citigroup announced subprime-related write-downs of $8 billion to $11 billion, the majority of which resulted from write-downs in super-senior positions. (¶ 115.)[11] For the fourth quarter 2007, Citigroup ultimately took a $21 billion write-down—$14 billion of which related to super-senior tranches of CDOs, and another $4 billion of which related to other CDO and subprime exposures. (Ex. 15 at 48; ¶ 5.) In 2008, through the third quarter, Citigroup has taken

[10] The market had always considered super-senior tranches of CDOs to be protected from significant losses due to their above AAA rating and historically low levels of default. In April, 2007, the International Monetary Fund expressed the view that the "deterioration in the credit quality of subprime mortgages" was "not likely to pose a serious systemic threat" to CDO "tranches rated A or higher." (Ex. 13 at 6–7.) Indeed, through the beginning of October 2007, there had still been virtually no downgrades of AAA CDO tranches by the ratings agencies. (*See* Ex. 14 at 2.)

[11] On the same day, Charles Prince announced his retirement from the company and resigned from his position as Chairman of the Board and Chief Executive Officer. (¶ 119.)

an additional $36 billion in write-downs, including $15 billion on CDO and other subprime exposures. (Ex. 16 at 22; Ex. 17 at 30; Ex. 18 at 34.)

Citigroup is certainly not alone among financial service companies in reporting unfavorable results in late 2007 and into 2008. (¶ 1.) Dislocations in the credit and subprime markets have wracked the entire financial industry and continue to plague the nation's economy. Citigroup's peers in the financial industry have suffered losses on a similar or even greater scale:

Company	**Total write-downs and credit losses since Jan 2007 ($bn)**
Wachovia	96.5
Merrill Lynch	55.9
Washington Mutual	45.6
UBS	44.2
HSBC	33.1
Bank of America	27.4
National City	26.2
JPMorgan Chase	20.5
Wells Fargo	17.7
Morgan Stanley	15.7
Royal Bank of Scotland	15.7
Lehman Brothers	13.8
Credit Suisse	13.4

(Ex. 19.)

Indeed, several financial firms have collapsed under the weight of the current market crisis. On May 31, 2008, Bear Stearns was acquired by JPMorgan Chase for $10 a share, although its stock traded above $170 a share in 2007. (Ex. 20 at 1; Ex. 21 at 1.) On September 15, 2008, after its stock plummeted to less than $1 per share, Lehman Brothers filed for Chapter 11 bankruptcy protection. (Ex. 22 at 1; Ex. 23 at 1.) Also on September 15, 2008, after seeing the price of its stock decline from $97.53 per share at the beginning of 2007, Merrill agreed to be acquired by Bank of America in a $50 billion all-stock transaction. (Ex. 24; Ex. 25 at 1.) On September 25, 2008, Washington Mutual became the largest bank in U.S. history to

fail when it was seized by the FDIC; its banking assets were sold to JPMorgan Chase for $1.9 billion. (Ex. 26 at 1.) In October 2008, Wachovia agreed to merge into Wells Fargo for $15 billion. (Ex. 27.) Moreover, in 2008, Morgan Stanley and Goldman Sachs both transformed themselves into bank holding companies in order to shore up liquidity and long-term capital. (Ex. 28; Ex. 29.)

V. The Market Failed to Predict the Magnitude of the Market Dislocation

Plaintiffs assert that "numerous warning signs" made the worst market crisis since the Depression "foreseeable" by the November 2007 Directors (*see, e.g.*, ¶¶ 73–77), but do not explain how such prescience could have been possible. Indeed, most market participants—including market regulators—did not anticipate the contagion effect of the subprime mortgage dislocations on the broader economy or the ultimate extent of what we now know, by virtue of hindsight, to be the beginning of a cataclysmic market collapse.

- In March 2008, Federal Reserve Vice Chairman Donald Kohn stated: "We probably didn't recognize [the risk] to the extent it ended up existing. This is a very unusual event, there are no excuses, but I ***think it would've been hard to see a year ago where we are today***." (Ex. 30 at 51.)

- In March 2008, Federal Reserve Vice Chairman Kohn stated: "I don't know that we fully appreciated all the risks out there. . . . ***I'm not sure anybody did***, to be perfectly honest." (*Id.* at 46.)

- In October 2008, Former Chairman of the Federal Reserve Alan Greenspan stated that "***[w]e are in the midst of a once in a century credit tsunami***. . . . The crisis . . . has turned out to be much broader than anything I could have imagined." (Ex. 31 at 15.) "[I]f you go back and ask yourself how in the early years anybody could realistically make judgments as to what was ultimately going to happen to subprime, ***I think you are asking more than anybody is capable of judging***." (*Id.* at 101–02.)

- In October 2008, SEC Chairman Christopher Cox stated: "I think that ***every regulator wishes that he or she had been able to predict the unprecedented meltdown*** of the entire U.S. mortgage market which was the fundamental cause of this crisis." (*Id*. at 22.)

- In October 2008, Senior Vice President of the Center for Responsible Lending Eric Stein stated: "[***T***]***he current financial crisis*** . . . ***is much broader in scope and more severe than we had foreseen***." (Ex. 32 at 2.)

- In November 2008, Treasury Secretary Henry Paulson stated: "***We have not in our lifetime dealt with a financial crisis of this severity and unpredictability***." (Ex. 33 at 2.)

- In November 2008, Former Chairman of the SEC David Ruder stated that "***[o]ne key aspect of the credit crisis was the failure of both market participants and regulators to predict the collapse*** of the home loan mortgage market. None of the primary market participants predicted the collapse. The risk management systems of most banks, investment banks, ratings agencies, and credit default swap insurers did not predict the collapse. ***Regulators, including the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Department of Treasury, the SEC, and the Commodity Futures Trading Commission did not predict the collapse***." (Ex. 34 at 4.)

ARGUMENT

I. THIS ACTION SHOULD BE DISMISSED OR STAYED IN FAVOR OF THE PARALLEL SHAREHOLDER DERIVATIVE PROCEEDING IN THE SOUTHERN DISTRICT OF NEW YORK

Where a parallel action involving the same parties and the same issues is pending in another jurisdiction, Delaware courts may dismiss or stay the Delaware action under a standard "akin to a *forum non conveniens* analysis." *In re Bear Stearns Cos., S'holder Litig.*, 2008 WL 959992, at *5 (Del. Ch. Apr. 9, 2008) (staying Delaware shareholder action in favor of contemporaneously filed action in New York state court). Delaware courts evaluate a motion to dismiss or stay on *forum non conveniens* grounds in light of multiple considerations, including the "applicability of Delaware law," "the relative ease of access to proof," the "pendency or non-pendency of a similar action or actions in another jurisdiction," and "all other practical considerations that would make the trial easy, expeditious, and inexpensive." *Id.*; *see In re Chambers Dev. Co., S'holders Litig.*, 1993 WL 179335, at *2 (Del. Ch. May 20, 1993) (staying derivative action in favor of pending federal derivative action where "four of the six factors weigh in favor of a stay"); *Apple Computer, Inc. v. Exponential Tech., Inc.*, 1999 WL 39547, at *14–16 (Del. Ch. Jan. 21, 1999) (staying certain counts in Delaware derivative action pending preliminary injunction ruling in California action). Here, virtually all of the relevant factors support dismissal or stay of this action in favor of the federal derivative action pending in the Southern District of New York.

This action involves substantially the same claims and parties as the federal derivative action. Plaintiffs in both consolidated actions seek to pursue, on behalf of Citigroup, claims for breach of fiduciary duty, waste and mismanagement against the Company's current

and former directors and officers in connection with losses on subprime-related assets in the second half of 2007. (*Compare* Complaint *with* Ex. 35.) *See In re Chambers*, 1993 WL 179335, at *6 (finding stay of state derivative action warranted, even though it was not a "mirror image" of federal action).[12] However, the federal derivative action also includes an alleged claim, on behalf of the Company, for violation of Section 10(b) and Rule 10b-5 of the Securities Exchange Act. (Ex. 35 at ¶¶ 129–138.)[13] Because that claim can only be adjudicated by a federal court, *see* 15 U.S.C.A. § 78aa, the Southern District of New York is the "only forum capable of granting complete relief on all the issues arising out of the transactions which are the subject of this litigation." *Issen & Settler v. GCS Enters., Inc.*, 1981 WL 15131, at *4 (Del. Ch. Dec. 7, 1981); *see Schnell v. Porta Sys. Corp.*, 1994 WL 148276, at *5 (Del. Ch. Apr. 12, 1994) (staying Delaware action in favor of federal action in New York where "Delaware law would govern only one of the counts asserted in the two actions and the New York federal court is capable of applying the Delaware law of fiduciary duty").

New York is also the center of gravity for the events at issue in the derivative actions and all, or substantially all, of the documents and witnesses are in New York. The

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[12] *See also McWane Cast Iron Pipe Corp. v. McDowell-Wellman Eng'g Co.*, 263 A.2d 281 (Del. 1970) (holding that Delaware courts have broad discretion to dismiss or stay duplicative litigation "when there is a prior action pending elsewhere, in a court capable of doing prompt and complete justice, involving the same parties and the same issues"). The first shareholder derivative action relating to Citigroup's subprime-related losses was filed in the U.S. District Court for the Southern District of New York on November 6, 2007. *Harris v. Prince et al.*, No. 07 Civ. 9841 (SHS) (S.D.N.Y.). The first of the actions now consolidated before this Court was filed two days later. *Kops v. Prince et al.*, Civ. Action No. 3338-CC (Del. Ch.). The Court may dismiss or stay this action in favor of the consolidated derivative proceeding in the Southern District of New York on the alternative basis set forth in *McWane*.

[13] Plaintiffs in the New York derivative action ground this unorthodox legal theory on the allegation that "[d]uring the period of [the alleged] public misrepresentations and omissions [the Board] approved a stock repurchase by Citigroup that resulted in the Company purchasing its own shares in the open-market [*sic*] at an artificially inflated price." (Ex. 35 ¶ 131.)

"relative ease of access to proof" in New York therefore favors a stay of this action. *See Royal Indem. Co. v. Gen. Motors Corp.*, 2005 WL 1952933, at *9 (Del. Super. July 26, 2005) (dismissing Delaware action in favor of action before Michigan court, where some of the witnesses and evidence were located); *Azurix Corp. v. Synagro Techs., Inc.*, 2000 WL 193117, at *5 (Del. Ch. Feb. 3, 2000) (staying Delaware action in favor of Texas case where documents had been produced and where "almost all the relevant witnesses are located"); *In re Chambers*, 1993 WL 179335, at *4 (staying action in favor of Pennsylvania action in part because corporation's headquarters were located in Pittsburgh, "[t]he individual defendants all reside in that city," and "virtually all pertinent documents and most potential non-party witnesses are located in Pennsylvania").

Moreover, because the securities fraud and ERISA actions arising from the same operative facts are already pending in the Southern District of New York before Judge Stein—the same judge overseeing the federal derivative action—dismissal or stay of this action is the only way to "avoid [ ] the wasteful duplication of time, effort and expense that occurs when judges, lawyers, parties and witnesses are simultaneously engaged in the adjudication of the same cause of action in two courts." *Dura Pharm., Inc. v. Scandipharm, Inc.*, 713 A.2d 925, 928 (Del. Ch. 1998) (citing *McWane*, 263 A.2d at 283). Litigation in New York therefore satisfies "all other practical considerations that would make the trial easy, expeditious, and inexpensive." *In re Bear Stearns*, 2008 WL 959992, at *5; *accord Royal Indem.*, 2005 WL 1952933, at *10.

Certainly, there can be no doubt that Judge Stein is capable of adjudicating Delaware fiduciary duty claims, applying Delaware law, and resolving the litigation with efficiency and expertise. As noted above, Judge Stein is now presiding over three different consolidated proceedings arising out of Citigroup's subprime losses and he has entered case

management orders calling for prompt briefing of motions to dismiss those actions. Nor is there any reason to doubt that lead plaintiff and interim lead counsel in the federal derivative action are competent to litigate the derivative claims. Five different shareholders competed for designation as lead plaintiff in the federal action, and each asked that its lawyers be selected as lead counsel. (Ex. 36 at 4.) Judge Stein took extensive briefing on the lead plaintiff/counsel motions, with exhibits reaching well into the hundreds of pages; heard extensive oral arguments; and then announced his decision in a lengthy and carefully reasoned oral ruling. *See In re Citigroup, Inc. S'holder Deriv. Litig.*, No 07 Civ. 9841 (Docket Nos. 4–23) (Ex. 36). Judge Stein appointed Walter E. Ryan (with whom this court is familiar from the *Ryan v. Gifford* litigation, *see, e.g.*, *Ryan v. Gifford*, 918 A.2d 341 (Del. Ch. 2007)) and Sam Cohen interim lead plaintiffs, finding that they are "most capable in representing the interests of the class," and that their lawyers at Krislov & Associates and Brower & Piven "have substantial experience litigating shareholder derivative and securities actions." (*Id.* at 6, 12.)

While this Court has been reluctant to stay or dismiss actions that involve novel questions of Delaware law, *see Ryan*, 918 A.2d at 350; *In re Topps Co. S'holders Litig.*, 924 A.2d 951, 955, 960 (Del. Ch. 2007), Delaware courts have stressed that "the application of Delaware law is not conclusive in a *forum non conveniens* analysis," *In re Chambers*, 1993 WL 179335, at *3 (citing *Jim Walter Corp. v. Allen*, 1990 WL 3899, at *5 (Del. Ch. Jan. 12, 1990) (noting that the application of Delaware law "should by no means be regarded as conclusive")). Here, Plaintiffs' claims "do not raise substantial or novel" issues of Delaware law. *In re Chambers*, 1993 WL 179335, at *3. This action calls for the straightforward application of the *Caremark* standard to allegations that risks were improperly managed and disclosed. This Court has applied that standard as a matter of routine in cases such as *Guttman v. Huang*, 823 A.2d

492, 505–07 (Del. Ch. 2003), *David B. Shaev Profit Sharing Account v. Armstrong*, 2006 WL 391931, at *4–6 (Del. Ch. Feb. 13, 2006), *aff'd.*, 911 A.2d 802 (Del. 2006) and *Rattner v. Bidzos*, 2003 WL 22284323, at *12–14 (Del. Ch. Sept. 30, 2003). *See* Point II.B, *infra*. The Southern District of New York has likewise proven itself fully capable of applying the *Caremark* standard. *See Sampson v. Robinson*, 2008 WL 3884386, at *7–8 (S.D.N.Y. Aug. 20, 2008); *In re IAC/InterActive Sec. Litig.*, 478 F. Supp. 2d 574, 605–06 (S.D.N.Y. 2007); *Ferre v. McGrath*, 2007 WL 1180650, at *3–10 (S.D.N.Y. Feb. 16, 2007); *Halpert Enters., Inc. v. Harrison*, 362 F. Supp. 2d 426, 432 (S.D.N.Y. 2005).

For all of the above reasons, Defendants respectfully request that the Court dismiss or stay this action in favor of the consolidated derivative action currently pending in the Southern District of New York.

II. THE COMPLAINT MUST BE DISMISSED FOR FAILURE TO MAKE A PRE-SUIT DEMAND

In the alternative, this Court should dismiss Plaintiffs' Complaint under Court of Chancery Rule 23.1 for failure to make a pre-suit demand upon Citigroup's Board, and because the Complaint does not meet the stringent pleading requirements necessary to excuse demand.

The decision whether to start a lawsuit on behalf of a corporation belongs to the corporation's board of directors. *See, e.g.*, *Spiegel v. Buntrock*, 571 A.2d 767, 773 (Del. 1990). This follows from the "cardinal precept of the General Corporation Law . . . that directors, rather than shareholders, manage the business and affairs of the corporation." *Aronson*, 473 A.2d at 811. Accordingly, if a shareholder wants to cause a corporation to pursue litigation, the shareholder must either (1) make a pre-suit demand, presenting the allegations to the corporation's directors and requesting that they bring suit; or else (2) plead facts showing that a

demand upon the board would have been futile. *Stone v. Ritter*, 911 A.2d 362, 366–67 (Del. 2006).

Where, as here, a plaintiff fails to make a pre-suit demand upon the board, the complaint must plead *with particularity* facts showing that a demand upon the board would have been futile. Ct. Ch. R. 23.1(a); *see also Stone*, 911 A.2d at 367; *Brehm*, 746 A.2d at 254. Conclusory allegations are not enough. *In re infoUSA, Inc. S'holders Litig.*, 953 A.2d 963, 985 (Del. Ch. 2007). Dismissal is mandatory under Rule 23.1 where plaintiffs fail to meet this heightened standard. *Brehm*, 746 A.2d at 254.[14]

In order to meet the heightened pleading requirements for demand futility, plaintiffs must provide particularized allegations showing that (1) the directors are not disinterested and independent, or (2) the challenged transaction was not the product of a valid exercise of business judgment. *Aronson*, 473 A.2d at 814; *see Brehm*, 746 A.2d at 256. Where plaintiffs complain of board inaction and do not challenge a specific decision of the board, plaintiffs must plead particularized facts creating a reasonable doubt that, as of the time the complaint was filed, the Board could have properly exercised its independent and disinterested business judgment in responding to a demand. *Rales v. Blasband*, 634 A.2d 927, 933–34 (Del. 1993). Here, only the claim for waste (Count III), challenges a decision by the Board and requires application of the full *Aronson* test.

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[14] The demand requirement serves as a "bulwark to protect the managerial discretion of directors." *In re infoUSA*, 953 A.2d at 989. It protects corporations from being forced to participate in actions that the directors deem to be not in the corporation's best interests. *See Spiegel*, 571 A.2d at 773; *see also Grimes v. Donald*, 673 A.2d 1207, 1217 (Del. 1996) (demand requirement serves to "deter costly, baseless suits by creating a screening mechanism to eliminate claims where there is only a suspicion expressed solely in conclusory terms"), *overruled on other grounds by Brehm*, 746 A.2d at 254.

A. Plaintiffs Do Not Dispute that a Majority of the Board Was Independent and Disinterested

Because "directors are entitled to a presumption that they were faithful to their fiduciary duties," plaintiffs bear a heavy burden of pleading specific facts showing that a *majority* of the directors lacked disinterestedness or independence. *Beam v. Stewart*, 845 A.2d 1040, 1048–49 (Del. 2004) (italics omitted); *see also Rales*, 634 A.2d at 933. Only one member of the November 2007 Board—Rubin—was employed by Citigroup other than as an outside director at the time the Complaint was filed. Where the vast majority of board members are outside directors, the makeup of the board supports the presumption that a majority of the board is disinterested and independent.[15] *See In re W. Nat'l. Corp. S'holders Litig.*, 2000 WL 710192, at *15 (Del. Ch. May 22, 2000) ("[A]ll five [directors] were outside directors—presumptively disinterested and independent."). Plaintiffs do not dispute that the vast majority of the November 2007 Board was independent for purposes of evaluating a demand.[16]

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[15] Plaintiffs' assertion that the Board previously determined that Ramirez is not an independent director (¶ 182) is mistaken. Citigroup's annual proxy identified 11 directors as meeting a definition of "independent" under the corporate governance rules of the New York Stock Exchange—*i.e.*, no material relationship with the Company—for purposes of Board composition and service on certain Board committees. (Ex. 1 at 8.) The requirement defined in the Proxy is unrelated to the legal standard of independence necessary to be able to assess a demand. *See, e.g.*, *In re Oracle Corp. Deriv. Litig.*, 824 A.2d 917, 941 n.62 (Del. Ch. 2003) (finding that director independence must be determined contextually and noting that the definition of independence adopted by the New York Stock Exchange reflects a narrower conception of independence that does not take into account the board decision at issue).

[16] Plaintiffs' arguments that Rubin lacks independence because he is beholden to members of the Board's Personnel and Compensation Committee, and that he faces a substantial threat of liability for insider trading, lack merit. (¶ 181.) Plaintiffs have not pled that the members of the Personnel and Compensation Committee are themselves interested, or that Rubin would rather jeopardize his reputation and career than risk his relationship with those directors. *Beam*, 845 A.2d at 1050 (To plead lack of independence, a plaintiff must demonstrate that a director is so "'beholden' to an interested director" that his or her 'discretion would be sterilized.'" (quoting *Rales*, 634 A.2d at 936)). Plaintiffs also fail to tie even a single alleged stock sale by Rubin to specific material, non-public information or to show that such sales were

(footnote continued)

B. Plaintiffs' Allegations Fail to Plead a Substantial Likelihood of Personal Liability

Unwilling to accept that Citigroup might have legitimately suffered losses under the most adverse conditions the financial industry has seen in decades and accurately disclosed its losses as they occurred, Plaintiffs surmise that the Company's disclosures prior to November 4, 2007 must have been inaccurate, the Company must have taken on improper subprime risks, and the directors must have breached their fiduciary duties by failing to: "(i) . . . prevent[] Citigroup from issuing false financial reports followed by embarrassing and ultimately costly write-downs; (ii) adequately monitor Citigroup's financial reporting; and (iii) detect, prevent and/or halt the significant risks associated with the Company's exposure to the subprime crisis." (¶ 174.) Based on this faulty logic and conclusory assertions, Plaintiffs allege that the November 2007 Directors could not have fairly considered a demand because they face a substantial likelihood of personal liability with respect to Plaintiffs' claims.

Plaintiffs are wrong. The mere threat of liability of the directors is insufficient to excuse demand; courts have consistently held that demand is not futile solely because directors would be deciding whether to sue themselves. *See Jacobs v. Yang*, 2004 WL 1728521, at *6 n.31 (Del. Ch. Aug. 2, 2004) ("Demand is not *per se* futile merely because directors would be suing themselves."), *aff'd*, 867 A.2d 902 (Del. 2005); *see also Brehm*, 746 A.2d at 257 n.34; *Aronson*, 473 A.2d at 815. Rather, demand may be excused based on allegations of wrongdoing

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(footnote continued)

made on the basis of such information. *See Guttman*, 823 A.2d at 504–505; *Rattner*, 2003 WL 22284323, at *10, *12. Moreover, as Rubin beneficially owned 5,290,334 shares of Citigroup common stock as of February 28, 2007 (*see* Ex. 37 at 16), his alleged stock sales constitute a minuscule 1.46% of his total ownership of Citigroup stock. Sales of such magnitude do not give rise to any adverse presumption. *See, e.g.*, *In re Oracle Corp.*, 867 A.2d 904, 954 (Del. Ch. 2004), *aff'd*, 872 A.2d 960 (Del. 2005).

only in "rare" cases where the complaint alleges that a majority of directors engaged in such "egregious" misconduct that a "substantial likelihood of director liability exists." *Seminaris v. Landa*, 662 A.2d 1350, 1354 (Del. Ch. 1995). Plaintiffs do not come close to meeting this standard.

As discussed in detail below, the allegations in the Complaint fail to rebut the presumption that the Directors acted in good faith in overseeing the Company's business. Plaintiffs also fail to allege facts linking the Directors to purported (and unspecified) misstatements or omissions in the Company's disclosures. Moreover, Plaintiffs ignore the fact that the Directors are exculpated for breach of the duty of care, and instead rely on allegations about Enron that are wholly irrelevant to the present case.

1. Plaintiffs' Allegations Fail to Rebut the Presumption that the Directors Acted in Good Faith

Directors are presumed to act in good faith, on an informed basis and in the belief that they are serving the best interests of the company. *Aronson*, 473 A.2d at 812. The purpose of the presumption is to prevent shareholders from asking the court to substitute their own hindsight notion of sound judgment for that of the corporation's board. *See Khanna v. McMinn*, 2006 WL 1388744, at *11 (Del. Ch. May 9, 2006) (noting "the fundamental principle that the board of directors manages the business and affairs of a corporation"); *see also Brehm*, 764 A.2d at 264 n.66 ("[D]irectors' decisions will be respected by courts" unless they "act in a manner that cannot be attributed to rational business purpose.").

Directors, for good reason, may not be held personally liable for every unfortunate outcome, nor even every illegal act, that occurs inside a Delaware corporation. *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959, 968 (Del. Ch. Sept. 25, 1996). Directors are not guarantors of favorable results, and unfavorable results do not prove bad faith by directors. *See*

Litt v. Wycoff, 2003 WL 1794724, at *10 (Del. Ch. Mar. 28, 2003) ("[T]he simple fact that [a] business decision caused significant loss does not dictate how that decision should be classified or evaluated."); *Gagliardi v. TriFoods Int'l, Inc.*, 683 A.2d 1049, 1051 (Del. Ch. 1996) ("The business outcome of an investment project that is unaffected by director self-interest or bad faith cannot itself be an occasion for director liability." (footnote omitted)).

Rather, Plaintiffs bear the heavy burden of rebutting the presumption of good faith by pleading, through particularized allegations, that the Board's actions were so egregious that they can be explained only by bad faith. *See Desimone v. Barrows*, 924 A.2d 908, 935 (Del. Ch. 2007) (finding that, to sufficiently plead failure-of-oversight liability, a plaintiff must show "that the directors acted with the state of mind traditionally used to define the mindset of a disloyal director"); *infoUSA*, 953 A.2d at 972.

Plaintiffs' allegations do not come close to satisfying this standard. The Complaint contains no particularized facts that would suggest that any director, much less a majority of the Board, acted irrationally or in bad faith. Instead, Plaintiffs recite a laundry list of public reports dating back to May 2005 regarding the housing and credit markets (¶¶ 73–74), label these reports "red flags" and assert that the market crisis of 2007 was "foreseeable" and "in plain sight," but that the directors "either failed to investigate . . . or turned a blind eye" (¶ 76), thus allowing the Company to develop subprime exposure and to repurchase company stock when those exposures existed (¶¶ 65, 77, 111–12, 194–95, 214).

These purported "red flags" relate to bankruptcies by mortgage lenders, analyst reports on housing prices, media reports on loan defaults, a decline in the ABX index, and liquidity problems at certain mortgage lenders. Plaintiffs do not explain how events in the housing market generally, none of which was specific to Citigroup, should have prompted an

investigation by the directors into the Company's holdings of CDO super senior tranches, which were considered by the market to be safe and which did not experience losses until market dislocation caused sudden and severe ratings downgrades of RMBS in late 2007. Indeed, as discussed above, some of the most sophisticated market observers, including rating agencies, the Federal Reserve, the Treasury Department, and Citigroup's own competitors viewed the troubles in the subprime mortgage market as a short-term and relatively contained problem. *See supra* pp. 9–14.

In any event, Plaintiffs cannot overcome the presumption that the Directors acted in good faith because: (a) Plaintiffs concede that the Citigroup Board had procedures and controls in place, (b) the Complaint does not set forth allegations of a systematic failure of oversight, and (c) the fact that Citigroup took risks and sustained losses does not evidence bad faith.

a. Plaintiffs Concede that the Citigroup Board Had Procedures and Controls In Place

Plaintiffs themselves allege that the Directors had procedures in place to review public disclosures and make business decisions in response to market events, including an Audit and Risk Management Committee comprised entirely of outside directors who were "audit committee financial experts." (¶¶ 15, 183.) Citigroup's Audit and Risk Management Committee Charter calls upon the Committee members to:

- meet at least quarterly, if not more often (Ex. 1 at B-2; ¶ 187);
- meet separately, periodically, with management, the company's internal auditors, its risk managers, and its independent auditors (Ex. 1 at B-2; ¶¶ 185, 187);
- review and discuss with management and the independent auditors, among other things, the company's annual audited financial statements and its quarterly financial statements, any developments with respect to reserves and regulatory

and accounting initiatives, as well as off-balance sheet structures, and their effect on the financial statements (Ex. 1 at B-2, B-3; ¶ 187);

- discuss generally the company's earnings press releases (Ex. 1 at B-2; ¶ 187); and
- review management's evaluation of the company's internal control structure and procedures for financial controls, and review at least quarterly management's conclusions about the efficacy of such controls and procedures (Ex. 1 at B-3; ¶ 187).

Plaintiffs do not allege that the Audit and Risk Management Committee failed to follow these procedures. To the contrary, they allege that the Committee "met frequently in both 2006 (11 meetings) and 2007 (12 meetings)" (¶ 189), and although they do not say so in their current pleading, Plaintiffs acknowledged in their First Amended Complaint that the Committee met for the express purpose of "discuss[ing] the risks associated with Citigroup's . . . subprime portfolios" (Ex. 39 ¶ 77). These allegations flatly contradict the conclusory allegations in Plaintiffs' current pleading that the directors "fail[ed] to take any steps to prevent, consider or account for the Company's staggering subprime exposure" and that the Audit Committee "failed to investigate the red flags regarding the subprime mortgage market and the risks associated with them or turned a blind eye toward the crisis occurring in plain sight." (¶¶ 76, 98.)

Indeed, this Court has rejected identical claims against Citigroup's oversight mechanisms in *David B. Shaev Profit Sharing Account*, 2006 WL 391931, a derivative case alleging fraud at Citigroup in relation to Enron and WorldCom. There, the Court dismissed the case, rejecting outright the plaintiff's contention that "only reckless indifference to fiduciary duty could explain the defendants' . . . lack of knowledge" (*Id*. at *5) of the misconduct at issue: "[T]he most the complaint alleges is that some admittedly troubling things happened at Citigroup, that the directors had erected a full panoply of audit systems designed to detect such misconduct, that for some reason the system failed to work, and that damages to Citigroup ensued." *Id.* at *1.

In reasoning that applies with full force to the allegations at issue here, Vice Chancellor Lamb stated that "the one thing that is emphatically not a *Caremark* claim is the bald allegation that directors bear liability where a concededly *well-constituted oversight mechanism*, having received *no specific indications of misconduct*, failed to discover fraud." *Id.* at *5 (emphasis added).

Indicia of board oversight, such as the existence of an active audit committee, and Plaintiffs' failure to identify any red flag that was brought to the Board's attention and ignored, preclude a finding of the kind of "sustained or systematic failure" that is essential to a *Caremark* claim. *See Guttman*, 823 A.2d at 506–07 (rejecting failure-of-oversight claim for failure to plead "critical" facts, such as "contentions that the company lacked an audit committee," that it "had an audit committee that met only sporadically and devoted patently inadequate time to its work or that the audit committee had clear notice of serious accounting irregularities and simply chose to ignore them or, even worse, to encourage their continuation"); *Stone*, 911 A.2d at 370 (stating that where a corporation has a system of internal reporting or controls, directors only fail their duty to monitor by "consciously . . . disabling themselves from being informed of risks or problems requiring their attention"); *see also Kanter v. Barella*, 388 F. Supp. 2d 474, 480 (D.N.J. 2005) (rejecting *Caremark* claims for failure "to show that the directors were conscious of the fact that they were not doing their jobs" and noting that "[i]n fact, Plaintiff concedes that [the company] had an audit committee which regularly communicated with [company] employees").

b. Plaintiffs Fail to Plead a Sustained or Systematic Failure of Oversight

Delaware courts have stated repeatedly that the failure-of-oversight theory that Plaintiffs are pressing here is "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment." *Caremark*, 698 A.2d at 967; *see Stone*, 911 A.2d at

372–73 (dismissing complaint for failure to allege a failure-of-oversight claim and noting that "[w]ith the benefit of hindsight, the plaintiffs' complaint seeks to equate a bad outcome with bad faith"); *see also Dellastatious v. Williams*, 242 F.3d 191, 196 (4th Cir. 2001) ("As *Caremark* indicates, mishaps within a corporation do not alone entitle a plaintiff to bring suit against directors in their personal capacities.").

In the *Caremark* case, this Court considered a failure of oversight claim that sought to recover fines and penalties that Caremark had paid after pleading guilty to violations of the health care laws. 698 A.2d at 960–61. This Court recognized the long-standing principle that "neither corporate boards nor senior officers can be charged with wrongdoing simply for assuming the integrity of employees." *Id.* at 969. It also noted that directors have an obligation to "assur[e] themselves that information and reporting systems exist . . . that are reasonably designed . . . to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance." *Id.* at 970.

Balancing these principles, this Court held that "only 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—will establish the *lack of good faith* that *is a necessary condition* to liability." *Id.* at 971 (emphasis added); *see also Stone*, 911 A.2d at 370 ("[A] showing of *bad faith conduct* . . . is essential to establish director oversight liability."). Liability on an oversight claim requires a showing that the directors *knew* they were not discharging their fiduciary obligations. *Caremark*, 698 A.2d at 970; *Guttman*, 823 A.2d at 506 (finding that failure of oversight liability is premised on a showing that the directors were "conscious of the fact that they were not doing their jobs"). Where, as here, a plaintiff pleads

that directors ignored "red flags," the plaintiff must plead "*particularized* facts suggesting that the board was presented with 'red flags' alerting it to potential misconduct." *Shaev*, 2006 WL 391931, at *5 (emphasis added); *In re Citigroup Inc. S'holders Litig.*, 2003 WL 21384599, at *2 (Del. Ch. June 5, 2003) (stating that red flags "are only useful when they are either waved in one's face or displayed so that they are visible to the careful observer"); *Ferre*, 2007 WL 1180650, at *8 (dismissing oversight claim where defendant failed to allege "a single particularized fact suggesting that" directors "were advised about any 'red flags indicating misconduct'" (quoting *Guttman*, 823 A.2d at 507)); *Kanter*, 388 F. Supp. 2d at 480 (finding that oversight liability exists only when directors turn a "blind eye" to unlawful practices of which "they were aware"); *Hazelton v. Kuttner*, 2007 WL 1120405, at *4 (D.S.C. Apr. 13, 2007) (rejecting failure-of-oversight claims where complaint "contain[ed] neither specific details regarding the company's internal controls nor particularized allegations regarding information or warning signs that had been brought to the attention" of the directors).

Here, not only have Plaintiffs *conceded* that Citigroup had proper oversight mechanisms in place, but Plaintiffs' chronology of public events in the financial and housing markets does not come close to a particularized pleading that red flags were brought to the Board's attention and ignored. Notably, not a single one of the public reports cited by Plaintiffs as a "red flag" is about Citigroup or Citigroup's business in subprime mortgage investments. The mere existence of a widespread problem in the industry is insufficient to show that directors were aware of problems occurring within the company. *See In re Mut. Funds Inv. Litig.*, 384 F. Supp. 2d 873, 879–80 (D. Md. 2005) (finding that, despite "copious coverage" on mutual fund late trading and market timing practices in the industry, derivative plaintiff must nonetheless allege that "trustees knew that widespread late trading and market timing activities were

occurring within the [company]"). This principle has even greater applicability here, where the reports about the housing market were general in nature and did not draw connections to, or predict problems with, the CDO investments to which the vast majority of Citigroup's write-downs in late 2007 relate. Given the universal inability of regulators and market participants to predict the magnitude or breadth of the market dislocation that seized world markets, and the effects sudden dislocation would have on super-senior tranches of CDOs, *see supra* pp. 9–14, Plaintiffs' suggestion that Citigroup's losses were "foreseeable" by the November 2007 Directors (¶ 33) and could rise to the level of "bad faith conduct" is absurd.

Delaware courts have "routinely reject[ed]" failure-of-oversight demand-futility claims, like the ones here, that are based on nothing more than conclusory allegations that, because of some unfavorable outcome, "internal controls must have been deficient, and the board must have known so." *Desimone*, 924 A.2d at 940; *see In re Baxter Int'l, Inc. S'holders Litig.*, 654 A.2d 1268, 1271 (Del. Ch. 1995) ("The complaint does not include anything specific about the alleged scheme suggesting that the directors must have known of it."); *Halpert*, 362 F. Supp. 2d at 432 (rejecting *Caremark* liability where complaint "never, except with conclusory allegations, conveys that the scheme occurred with the Board's knowledge or systemic failure to engage in proper oversight"); *Fink v. Komansky*, 2004 WL 2813166, at *4 (S.D.N.Y. Dec. 8, 2004) (dismissing oversight claims "[w]here plaintiff has 'not pled with particularity that directors ignored obvious danger signs of employee wrongdoing' but instead base [*sic*] his claim 'on a presumption that employee wrongdoing would not occur if directors performed their duty properly'" (quoting *In re Baxter*, 654 A.2d at 1270–71)).

c. Allegations that Citigroup Assumed Business Risk Do Not Excuse Demand

Plaintiffs' suggestion that the directors face a substantial likelihood of liability for failing to control and monitor "Citigroup's staggering risk associated with its dangerous exposure to the housing bubble" also fails to excuse demand. (¶ 7; *see* ¶¶ 174, 178.) Delaware law allows directors and officers to make aggressive decisions regarding risk. *See Gagliardi*, 683 A.2d at 1053; *In re Caremark*, 698 A.2d at 967. The fact that a plaintiff, or the Court, regards a decision as unwise is "legally unimportant." *Gagliardi*, 683 A.2d at 1053. Citigroup, like all financial institutions, is in the business of taking calculated risks. Plaintiffs themselves acknowledge that the risks taken by Citigroup in the subprime mortgage market have, in the past, generated profits for the company. (¶ 72.) The fact that losses were incurred—whether those losses are from CDO tranches or SIVs or mortgage loans—during an unprecedented market crisis does not create a substantial likelihood of liability for directors for allowing the company to take risks. *See, e.g.*, *United Artists Theatre Co. v. Walton*, 315 F.3d 217, 233 (3d Cir. 2003) (recognizing that the directors' management function includes making "economic choices and weighing the potential risk against the potential reward" (quoting 1 David A. Drexler, et al., *Delaware Corporation Law and Practice*, § 15.03 at 15-6) (2001))); *Teachers' Ret. Sys. of La. v. Aidinoff*, 900 A.2d 654, 668 (Del. Ch. 2006) ("[T]he burden of pleading and proving [failure of oversight claims] is rightly onerous, lest the business judgment rule's and § 102(b)(7)'s utility in encouraging risk-taking and board service be undermined."); *Wilson v. Tully*, 676 N.Y.S.2d 531, 537–38 (App. Div. 1998) (finding that a substantial likelihood of liability was not established based on allegations that directors failed to prevent company from assuming excessive risk).

2. The November 2007 Directors Do Not Face a Substantial Likelihood of Any Liability Relating to Citigroup Disclosures

Plaintiffs also allege that the November 2007 Directors, and particularly those directors who served on the Audit and Risk Committee, face a substantial likelihood of liability for Citigroup's "false and misleading public statements" about Citigroup's financial condition. (¶¶ 80, 178, 188, 90, 192.) However, despite citing every public disclosure made by Citigroup in 2007, Plaintiffs provide no particularized allegations as to why any particular statement or disclosure is false or misleading. Contrary to Plaintiffs' hindsight allegations and speculative suppositions, the fact that Citigroup disclosed subprime losses in the second half of 2007 does not mean Citigroup had any obligation either to announce or to warn of those events sooner.

In addition, Plaintiffs' argument fails because: (a) there are no allegations that the Directors were involved in preparing financial disclosures, (b) there are no allegations that the Directors were aware of any alleged misstatement or omission, and (c) there are no allegations establishing that the Directors had reason to question the reports of officers and experts.

a. Plaintiffs Do Not Allege That Directors Were Involved in Preparing Disclosures

Generalized allegations that Board members signed or allowed Citigroup to disseminate improper public disclosures, without more, do not sufficiently allege a substantial likelihood of liability.[17] *See, e.g.*, *Wood v. Baum*, 953 A.2d 136, 142 (Del. 2008) ("The Board's execution of [the company's] financial reports, without more, is insufficient to create an

[17] While the Audit Committee's purpose is to assist the board in fulfilling its oversight responsibilities—and while the procedures outlined in Point II.B.1(a) are designed to enable the Committee to fulfill that purpose—it is *not* the Committee's responsibility to determine that Citigroup's financial statements are complete and accurate. Nor is the Committee charged with the duty to determine that the financial statements comply with generally accepted accounting principles or applicable rules and regulations. Those responsibilities belong to Citigroup's management and its independent auditors. (Ex. 1 at B-1.)

inference that the directors had actual or constructive notice of any illegality."); *Rattner*, 2003 WL 22284323, at *12 (same); *see also In re Coca-Cola Enters., Inc. Deriv. Litig.*, 478 F. Supp. 2d 1369, 1377 (N.D. Ga. 2007) (holding that demand is not excused where the complaint fails to plead "particularized facts demonstrating the Board's involvement in the preparation of [the company's] allegedly false" statements); *Catholic Med. Mission Bd. v. Ritter*, No. 08 Civ. 0485 (N.D. Ala. Nov. 4, 2008) (dismissing derivative claims relating to disclosure of significant losses arising from investments in subprime assets where the complaint was "devoid of any particularized allegations tying these nine Current Board members to" alleged misstatements in press releases). Here, Plaintiffs have failed to plead any fact demonstrating the November 2007 Directors' involvement in the preparation of Citigroup's disclosures.

b. Plaintiffs Do Not Allege that Directors Were Aware of Any Alleged Misstatement or Omission

Nor have Plaintiffs alleged with particularity facts showing that the Board was aware of any alleged misstatement or omission in Citigroup's financial disclosures. *See supra* Point II.B.1(b).[18] Instead, Plaintiffs merely assert that members of the Audit and Risk Management Committee, "who qualify as 'audit committee financial experts,' undoubtedly understood and appreciated the risks" of subprime-related instruments (¶ 94) and that they "knew or should have known of any deficiencies" in Citigroup's financial statements and reporting processes (¶ 191). However, it is well-settled that directors are not held to a higher standard of care merely because they have professional qualifications. *See Can. Commercial Workers Indus.*

[18] *See also Ferre*, 2007 WL 1180650, at *8 (refusing to find substantial likelihood of liability where plaintiff failed to allege "specific facts showing that the members of the Audit Committee 'had clear notice of serious accounting irregularities and simply chose to ignore them or, even worse, to encourage their continuation'") (citation omitted); *Kenney v. Koenig*, 426 F. Supp. 2d 1175, 1183 (D. Colo. 2006) (same); *In re Coca-Cola*, 478 F. Supp. 2d at 1378 (same); *Caviness v. Evans*, 229 F.R.D. 354, 359–60 (D. Mass. 2005) (same).

Pension Plan v. Alden, 2006 WL 456786, at *7 n.54 (Del. Ch. Feb. 22, 2006) (rejecting the argument that directors with special expertise should be held to a higher standard of care solely because of their status as an expert); *see also In re Coca-Cola*, 478 F. Supp. 2d at 1379; *Egelhof v. Szulik*, 2006 WL 663410, at *10 (N.C. Super. Mar. 13, 2006).

c. Directors Are Entitled to Rely on Officers and Experts

Moreover, financial disclosures are prepared in the first instance by management and reviewed by independent auditors. (¶ 187.) Under Delaware law, directors are "fully protected" when they rely in good faith on the reports of officers or experts. 8 *Del. C.* § 141(e);[19] *see also Brehm*, 746 A.2d at 261; *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963) ("[D]irectors are entitled to rely on the honesty and integrity of their subordinates until something occurs to put them on suspicion that something is wrong."); *Ash v. McCall*, 2000 WL 1370341, at *9 (Del. Ch. Sept. 15, 2000) (holding that an expert's favorable advice to the board serves as a prominent "green flag" assuring the directors that things are in order); *see also Cantor v. Perelman*, 235 F. Supp. 2d 377, 387–88 (D. Del. 2002) (holding that section 141(e) protected directors from liability for "allegations of accounting abuses" because directors relied on clean audit opinions provided by outside auditors), *aff'd in part, rev'd in part on other grounds*, 414 F.3d 430 (3d Cir. 2005); *Ash*, 2000 WL 1370341, at *9 (rejecting substantial likelihood of liability argument relating to accuracy of financial disclosures where directors relied on expert accountants and financial advisors). Plaintiffs do not allege that information

[19] Section 141(e) states, in pertinent part, that "[a] member of the board of directors, or a member of any committee designated by the board of directors, shall . . . be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees . . . or by any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation."

received from management or the Company's outside auditors was inaccurate (or in what way that information was inaccurate), that the Board was alerted of any inaccuracies, or that the Board did not rely on management and experts in good faith.

3. The Directors Are Exculpated for Breaches of the Duty of Care

The inadequacy of Plaintiffs' argument about director liability is deepened by the fact that Citigroup's charter, as permitted by Delaware law,[20] contains an exculpatory clause that shields Citigroup's directors from personal liability for breaches of their fiduciary duty of care. Article TENTH of Citigroup's charter provides:

> No director of the Corporation shall be liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except for liability (i) for any breach of the director's duty of loyalty to the Corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of the Delaware General Corporation Law, or (iv) for any transaction from which the director derived an improper personal benefit.

(Ex. 40 at 13.)

Delaware courts have repeatedly held that where a certificate of incorporation eliminates director liability under Section 102(b)(7), dismissal is warranted when a complaint fails adequately to allege facts sufficient to give rise to an inference of conduct within one of Section 102(b)(7)'s exceptions. *See, e.g.*, *Malpiede v. Townson*, 780 A.2d 1075, 1094–95 (Del.

[20] Section 102(b)(7) of the Delaware Corporate Law permits shareholders to adopt certificate of incorporation provisions "eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director," with the exception of liability (i) for breach of the director's "duty of loyalty to the corporation or its stockholders," (ii) for "acts or omissions not in good faith," or that "involve intentional misconduct or a knowing violation of law," (iii) under Del. Gen. Corp. Law § 174, which prohibits unlawful payments of dividends and unlawful stock purchases and redemptions, and (iv) for "any transaction from which the director derived an improper personal benefit." 8 *Del. C.* § 102(b)(7); *see also Emerald Pr's v. Berlin*, 787 A.2d 85, 90 (Del. 2001).

2001) ("[E]ven if the plaintiffs had stated a claim for gross negligence, such a well-pleaded claim is unavailing because defendants have brought forth the Section 102(b)(7) charter provision that bars such claims. This is the end of the case."); *Laties v. Wise*, 2005 WL 3501709, at *2 (Del. Ch. Dec. 14, 2005) (dismissing complaint pursuant to Section 102(b)(7) where complaint did not assert bad faith, intentional misconduct, or knowing violation of law); *Cooke v. Oolie*, 1997 WL 367034, at *10–11 (Del. Ch. June 23, 1997) (dismissing claim under Section 102(b)(7) where plaintiffs only alleged breaches of duty of care and waste); *see also Ryan v. Lyondell Chem. Co.*, 2008 WL 2923427, at *21 n.126 (Del. Ch. July 29, 2008) ("When there is no evidence of disloyalty or bad faith in connection with the failure to disclose . . . a Section 102(b)(7) provision will absolve the directors of monetary liability for their failure because only their duty of care is at issue.").

As shown above, Plaintiffs fail to present particularized allegations of bad faith on the part of *any* of the November 2007 Directors, much less a majority of them. *See supra* Point II.B.1. Plaintiffs' claims are nothing more than allegations that the directors breached their duty of care. The Complaint alleges that the November 2007 Directors failed to "implement proper controls" (¶ 1), "failed to monitor [Citigroup's] operations" (¶ 7), "disregarded risks" associated with exposure to subprime assets (¶ 8), failed "to control [Citigroup's] exposure to the subprime lending crisis" (¶ 11), failed to "investigate, mitigate and/or quantify [Citigroup's] subprime lending exposure" (¶ 81), and failed to "adequately scrutinize Citigroup's exposure to [subprime] risk" (¶ 191). All of Plaintiffs' claims are therefore covered under the exculpatory provision of Citigroup's charter.[21] The boilerplate assertion that Defendants breached "their

[21] *See Lyondell*, 2008 WL 2923427, at *21 (dismissing complaint because plaintiff had "not brought forth any evidence to suggest that the Board intentionally misled the (footnote continued)

fiduciary duties of care, loyalty, disclosure, reasonable inquiry, oversight, good faith and supervision" (¶ 202) does not change the nature of the claim.

Because Plaintiffs' claims fall squarely within the scope of Citigroup's Section 102(b)(7) provision, the exculpatory provision disposes of all of Plaintiffs' claims against the November 2007 Directors. As such, the exculpatory provision, even standing alone, negates Plaintiffs' suggestion that the Board was interested, and therefore disabled from considering a demand to bring suit, because the directors face a substantial likelihood of liability.

4. Plaintiffs' Enron-Related Allegations Are Irrelevant

One of the principal differences between Plaintiffs' first and second amended complaints is the addition of no fewer than twenty paragraphs relating to alleged "Prior Reckless Conduct" by Citigroup, with a particular emphasis on Citigroup's involvement in events preceding the 2001 bankruptcy of Enron Corp. (¶¶ 45–64.) These allegations are uniformly beside the point and entirely irrelevant to the demand futility analysis.

Plaintiffs' theory seems to be that these unrelated events collectively amounted to an additional "red flag" that should have alerted Citigroup's board to the risks associated with subprime assets. (¶ 179 (alleging that demand is excused because certain directors "were also members of the Board during the Company's prior reckless exposure in connection with Enron

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(footnote continued)

shareholders" and Section 102(b)(7) absolves directors of liability for duty of care); *In re Baxter*, 654 A.2d at 1269–70 (claim that directors "knew, were reckless or grossly negligent in causing or failing to prevent" a fraudulent scheme by employees fell within scope of exculpatory provision); *In re Lukens Inc. S'holders Litig.*, 757 A.2d 720, 731–32 (Del. Ch. 1999) ("[W]ithout some factual basis to suspect [the directors'] motivations," a complaint implicates the duty of care, not the duties of loyalty or good faith); *see also Emerald Pr's*, 787 A.2d at 92 ("[I]n actions against the directors of Delaware corporations with a Section 102(b)(7) charter provision, a shareholder's complaint must allege well-pled facts that, if true, implicate breaches of loyalty or good faith.").

and other contemporaneous financial debacles").) Putting aside the fact that there is no allegation that the directors ignored the risks in the subprime market, or that the internal oversight functions failed to work properly, *see supra* Point II.B.1, Plaintiffs fail to draw any legitimate connection between the historical Enron-related events and the subprime-related losses that Citigroup suffered beginning in July 2007. In fact, there is no connection between what happened at Enron—which plaintiffs characterize as an "institutionalized, systematic, and creatively planned accounting fraud" (¶ 45)—and the losses and write-downs that Citigroup has taken in connection with the industry-wide subprime crisis.[22] Plaintiffs are not excused from making a demand on the Board on the basis of their new allegations relating to irrelevant prior events.

In any event, this Court has previously dismissed a derivative action against Citigroup directors (eight of whom are also on the November 2007 Board) in connection with Enron matters for failure to plead demand futility. *See Shaev*, 2006 WL 391931, at *1 (dismissing complaint against Citigroup directors for alleging "literally nothing to suggest that the defendants willfully or recklessly ignored information that would have led to the discovery" of alleged misconduct pertaining to Enron and noting that the complaint conceded "that the directors had erected a full panoply of audit systems designed to detect misconduct").

[22] Plaintiffs try to draw a connection between the Enron scandal and Citigroup's recent subprime losses through a misleading description of Citigroup's involvement with Structured Investment Vehicles, or SIVs. (¶¶ 70–72.) The theory is that Enron *abused* special purpose entities, and SIVs *are* types of special purpose entities, so therefore Citigroup's directors should have known to stay away from SIVs. Plaintiffs fail to acknowledge, however, that (1) special purpose entities are commonplace, and there is nothing *per se* wrong with them, and (2) the SIVs that Citigroup managed had only minimal exposure to subprime mortgages. Thus, Plaintiffs' allegations are simply a red herring.

III. PLAINTIFFS FAIL TO ALLEGE DEMAND FUTILITY FOR THEIR WASTE CLAIM

Because Plaintiffs' waste claim (Count III) is based on Board approval of the November 4 letter agreement with Mr. Prince and Board approval of a $645 million stock repurchase in the first quarter of 2007, the issue of demand futility on this claim must be analyzed under both prongs of the *Aronson* test.[23] To prevail, Plaintiffs must plead particularized facts sufficient to create a reasonable doubt that either (i) a majority of "the directors are disinterested and independent," or (ii) the "challenged transaction was . . . the product of a valid exercise of business judgment." *Aronson*, 473 A.2d at 814.

A. Plaintiffs Fail to Create a Reasonable Doubt As To Whether the November 4 Agreement Was a Valid Exercise of Business Judgment

On the first prong of *Aronson*, Plaintiffs do not contest the independence of a majority of the directors, and they do not allege that any of the directors had any personal interest in approving the agreement with Mr. Prince. Accordingly, the only issue is whether, under *Aronson's* second prong, Plaintiffs have pleaded particularized facts sufficient to create a reasonable doubt as to whether the approval of the agreement was a valid exercise of the directors' business judgment. They have not.

The business judgment rule is a "presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." *Aronson*, 473 A.2d at 812. The presumption honors the "managerial prerogatives of Delaware directors under Section 141(a) of

[23] To the extent Plaintiffs' waste claim is based on allegations that the Board "allow[ed] the Company to purchase" subprime loans from Accredited Home Lenders and Ameriquest Home Mortgage, the claim is one of Board *inaction* and should be dismissed for failure to plead demand futility under the first prong of *Aronson*. *See supra* II.A-II.B.

the General Corporation Law." *Id.* When it comes to board decisions on executive compensation, the business judgment rule affords directors great deference, recognizing that "[i]t is the essence of business judgment for a board to determine if 'a particular individual warrant[s] large amounts of money, whether in the form of current salary or severance provisions.'" *Brehm*, 746 A.2d at 263 (quoting *In re Walt Disney Co. Deriv. Litig.*, 731 A.2d 342, 362 (Del. Ch. 1998)); *see also infoUSA*, 953 A.2d at 984 ("The value of assets bought and sold in the marketplace, including the personal services of executives and directors, is a matter best determined by the good faith judgments of disinterested and independent directors, men and women with business acumen appointed by shareholders precisely for their skill at making such evaluations.").

Plaintiffs have not alleged any failure of the directors to act on a properly informed basis in approving the agreement with Mr. Prince. *See Brehm*, 746 A.2d at 259 ("Board is responsible for considering only material facts that are reasonably available."). In fact, they do not allege anything at all about the Board's processes in considering the agreement with Mr. Prince.

Even if Plaintiffs had pleaded particularized facts creating a reasonable doubt as to whether the defendants violated their duty of care in approving the agreement with Mr. Prince, they have not pleaded anything to suggest that the directors acted in bad faith or received some improper benefit in connection with that agreement. *See In re Lear Corp. S'holder Litig.*, 2008 WL 4053221, at *13 (Del. Ch. Sept. 2, 2008) (stating that the concept of waste is "designed to smoke out shady, bad faith deals," not a "license for judicial scrutiny of arm's length bargains"). Accordingly, as discussed above, *see supra* Part II.B.3, the exculpatory provision in Citigroup's certificate of incorporation completely insulates the directors against monetary liability for the

waste claim that Plaintiffs assert. (Ex. 40 at 13.) The November 2007 Directors thus face no likelihood of liability on this claim, and Plaintiffs have no excuse for not making pre-suit demand.

That leaves Plaintiffs to contend that the agreement with Mr. Prince was "so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration." *In re Walt Disney*, 731 A.2d at 362 (internal quotation marks omitted). Plaintiffs try to meet this standard, but only in the most conclusory way. They parrot the "so one-sided" standard (¶ 213), but provide no particularized allegations to suggest that the terms of the agreement were so "irrational[]" as to violate the bounds of the business judgment rule. *Brehm*, 746 A.2d at 264; *see also Kernaghan v. Franklin*, 2008 WL 4450268, at *10 (S.D.N.Y. Sept. 29, 2008) (dismissing waste claim because plaintiff failed to plead facts showing that a compensation package was "so large or unreasonable that no person of ordinary, sound business judgment could conclude that the package represents a fair exchange" considering the company's budget, holdings or earnings).

Conclusory allegations aside, the actual terms of the agreement, which were disclosed before Plaintiffs filed their Complaint, refute Plaintiffs' notion of one-sidedness, as the agreement bound Mr. Prince to strict non-compete, non-solicitation, and non-disparagement clauses, as well as a general release of potential legal claims. (*See* Ex. 41 at 4–5; ¶¶ 122–24.)[24]

[24] Plaintiffs cite a press report stating that Mr. Prince "will leave Citigroup with $68 million." (¶ 122.) Under the actual terms of the November 4 letter agreement, the principal benefits that Mr. Prince receives are the vesting of previously awarded but as-yet-unvested stock and option awards; a 2007 incentive award based upon the award he received for 2006, but adjusted to reflect Citigroup's stock-price and dividend performance over 2007, and then adjusted again to reflect that Mr. Prince served only part of the year as CEO and Chairman; and an office, administrative assistant, car and driver (plus payment of any taxes relating to these services) through 2012 or until Mr. Prince begins full-time work for another employer. (Ex. 41

(footnote continued)

B. Plaintiffs Fail to Create a Reasonable Doubt as to Whether the Stock Repurchase Program Was a Valid Exercise of Business Judgment

Plaintiffs argue that "the Director Defendants authorized and did not suspend the Company's share repurchase program which resulted in the Company buying back over $645 million worth of the Company's shares at artificially inflated prices." (¶ 194.) Here, again, the Complaint does not even allege that any of the November 2007 Directors had a personal interest in the repurchase of Citigroup stock in the first quarter of 2007. Under the second prong of *Aronson*, Plaintiffs have the "heavy burden" of pleading particularized facts that raise a reasonable doubt about whether the stock repurchases are entitled to the protection of the business judgment rule. *White v. Panic*, 783 A.2d 543, 551 (Del. 2001); *see also Litt*, 2003 WL 1794724, at *6; *In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 808, 824 (Del. Ch. 2005). Yet all they offer is the conclusory assertion that the buybacks were not "valid exercises of business judgment." (¶ 194.)

In approving the challenged stock repurchases, the Citigroup Board is entitled to a presumption that it made its decision in good faith. *Litt*, 2003 WL 1794724, at *6. To rebut this presumption, Plaintiffs "must plead particularized facts sufficient to raise a reasonable doubt that the action was taken in good faith or reasonable doubt that the board was adequately informed in making the decision." *Id.* "A plaintiff who seeks to excuse demand through the second prong of *Aronson* . . . faces a task closely akin to proving that the underlying transaction *could not have been* a good faith exercise of business judgment." *Postorivo v. AG Paintball Holdings, Inc.*,

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(footnote continued)

at 2–3.) Mr. Prince is entitled to receive those benefits in exchange for his agreement to non-competition, non-solicitation, non-disparagement, and cooperation commitments and his grant of a general release to Citigroup.

2008 WL 553205, at *8 (Del. Ch. Feb. 29, 2008) (quoting *infoUSA*, 953 A.2d at 972) (emphasis in original); *see also Highland Legacy Ltd. v. Singer*, 2006 WL 741939, at *7 (Del. Ch. Mar. 17, 2006) (noting that the second prong of the *Aronson* test is "directed to *extreme* cases in which despite the appearance of independence and disinterest a decision is *so extreme or curious* as to itself raise a legitimate ground to justify further inquiry and judicial review" (internal quotation marks and citations omitted) (emphasis added)). If a board's decision can be "attributed to *any* rational business purpose," a Delaware court "will not substitute its own notions of what is or is not sound business judgment." *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971) (emphasis in original).

Here, Plaintiffs have failed to plead *any* facts regarding the circumstances under which the buybacks were conducted or the decision-making process used by the Board in approving these transactions. Moreover, the stock repurchases took place in the first quarter of 2007, months before the credit crisis descended upon the world economy. (¶ 112.) Having failed to raise a reasonable doubt that the stock repurchases were the product of good-faith business judgment, Plaintiffs are not excused from a pre-suit demand with respect to claims relating to the stock repurchasing program.

IV. THE DUE CARE CLAIMS AGAINST CITIGROUP'S PRESENT AND FORMER DIRECTORS SHOULD BE DISMISSED PURSUANT TO CITIGROUP'S CERTIFICATE OF INCORPORATION[25]

The claims in the Complaint for breach of fiduciary duty, mismanagement and waste are subject to dismissal as to Citigroup's present and former directors because, as stated above, Citigroup's charter contains an exculpatory provision that shields Citigroup's directors from personal liability for breaches of their fiduciary duty of care. Article TENTH of

[25] As stated above, nominal defendant Citigroup Inc. does not join this argument.

Citigroup's charter mirrors Section 102(b)(7) of the Delaware General Corporation Law, limiting the liability of directors excepting four situations as stated in the statute.

Delaware courts repeatedly have held that where a certificate of incorporation provision eliminates director liability for breaches of fiduciary duty pursuant to Section 102(b)(7), a complaint alleging a breach of fiduciary duty that does not implicate any of the four exceptions in Section 102(b)(7) must be dismissed as a matter of law. *See, e.g.*, *Malpiede*, 780 A.2d at 1092–96 (affirming dismissal of plaintiffs' due care claim pursuant to Section 102(b)(7)); *In re Lukens*, 757 A.2d at 734 (same); *Cooke*, 1997 WL 367034, at *10–11 (dismissing claim under Section 102(b)(7) where plaintiffs only alleged breaches of duty of care and waste).

As discussed above, the Complaint alleges only boilerplate duty of care claims, all of which must be dismissed as a matter of law pursuant to Article TENTH of Citigroup's Charter.

V. THE COMPLAINT SHOULD BE DISMISSED UNDER RULE 12(b)(6) FOR FAILURE TO STATE A CLAIM[26]

Court of Chancery Rule 12(b)(6) provides that a complaint must be dismissed where it fails to state a claim upon which relief can be granted. While the Court "must assume the truthfulness of all well-pleaded facts contained in the complaint, … [c]onclusory allegations unsupported by facts contained in the complaint, however, will not be accepted as true." *Manzo v. Rite Aid Corp.*, 2002 WL 31926606, at *3 (Del. Ch. Dec. 19, 2002); *see Grobow v. Perot*, 539 A.2d 180, 187 (Del. 1988) (stating that "upon a motion to dismiss, only well-pleaded allegations

[26] As stated above, nominal defendant Citigroup Inc. does not join this argument.

of fact must be accepted as true" and a court "need not blindly accept as true all allegations, nor must it draw all inferences from them in plaintiffs' favor unless they are reasonable inferences").

A. The Complaint Does Not State a Claim for Breach of the Duty of Oversight

As set forth above, *see supra* Point II.B.1(b), in order to plead a claim under Delaware law for breach of fiduciary duty based on an alleged failure of oversight, a plaintiff must allege that "(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system of controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention." *Stone*, 911 A.2d at 370. Because Plaintiffs conceded that Citigroup had reporting mechanisms and controls in place, and fail to plead that the Defendants did not follow such mechanisms, or that the Defendants received specific warnings about subprime-related problems at Citigroup and consciously ignored such warnings, the Complaint fails to state a claim for breach of the duty of oversight.

B. The Complaint Does Not State a Claim for the Breach of the Fiduciary Duty of Disclosure

The duty of disclosure is not an independent duty, but derives from the duties of care and loyalty. In order to state a claim for breach of fiduciary duty based on disclosures, Plaintiffs must plead that Defendants made "a materially false statement, by omitting a material fact, or by making a partial disclosure that is materially misleading." *Pfeffer v. Redstone*, 2008 WL 308450, at *8 (Del. Ch. Feb. 1, 2008); *see O'Reilly v. Transworld Healthcare, Inc.*, 745 A.2d 902, 916 (Del. Ch. 1999). As discussed above, Plaintiffs have not alleged with any particularity how Citigroup's disclosures were inaccurate. The mere fact that Citigroup announced losses in the latter half of 2007 does not suggest that its earlier disclosures (of more favorable results) were inaccurate. *See supra* Point II.B.2.

C. The Complaint Does Not State a Claim for Corporate Waste

In order to state a claim for corporate waste, a complaint must plead "an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade." *Brehm*, 746 A.2d at 263. A waste claim will lie only upon a finding that a challenged transaction "either served no purpose or was so completely bereft of consideration that the transfer is in effect a gift." *Criden v. Steinberg*, 2000 WL 354390, at *3 (Del. Ch. Mar. 23, 2000). If "there is *any substantial* consideration received by the corporation, and if there is a *good faith judgment* that in the circumstances the transaction is worthwhile, there should be no finding of waste." *Lewis v. Vogelstein*, 699 A.2d 327, 336 (Del. Ch. 1997) (emphasis in original). This standard is "obviously an extreme test, very rarely satisfied by a shareholder plaintiff." *Steiner v. Meyerson*, 1995 WL 441999, at *1 (Del. Ch. July 19, 1995). In fact, Delaware courts characterize it as "the rarest [cause of action with all its elements satisfied] of all—and indeed . . . possibly non existent." *Id.* at *5.

Plaintiffs assert that the Director Defendants allowed Citigroup to enter into an allegedly "one-sided" severance agreement with Defendant Prince (¶ 212–13), and that the Director Defendants and Defendants Prince, Jordan, Kleinfeld and Mecum are liable for waste for (1) allowing Citigroup to make "improvident investments" (¶ 77) by purchasing assets from Accredited Home Lenders and Ameriquest Home Mortgage in 2007 (¶ 214); (2) approving a $645 million buyback of Citigroup stock (¶ 215); and (3) "allowing the company to invest in SIVs that were unable to pay off maturing debt." (¶ 216.) These allegations fail to state a waste claim under the stringent standard dictated by Delaware law.

As discussed above, the Company received consideration under the November 4 agreement—namely that Mr. Prince is bound to strict non-compete, non-solicitation and non-disparagement clauses, as well as a general release of legal claims. (Ex. 41.) Mr. Prince's

compensation in stock has also been adjusted to reflect Citigroup's stock price and dividend performance over 2007 along with the fact that he served only part of the year as CEO and Chairman. *Id.*

With respect to Citigroup's investments in SIVs and the stock buybacks, the Complaint contains *no* allegation that these transactions were of no value when Citigroup entered into them. Indeed, Citigroup's disclosures make clear that the stock repurchase program "is used for many purposes, including to offset dilution from stock-based compensation programs." (Ex. 38 at 123.)

With respect to Citigroup's alleged purchase of loans from Accredited Home Lenders and Ameriquest Home Mortgage, the Complaint does not allege that Board approval either was required or given for such purchases. Nor does it allege that those loans lacked value at the time they were purchased, or even that they have since defaulted.

Because Plaintiffs' allegations fail to plead the kind of unconscionable transactions that are "bereft of consideration," they fail to state a claim for waste. *See Wagner v. Selinger*, 2000 WL 85318, at *3 (Del. Ch. Jan. 18, 2000).

D. The Complaint Does Not State a Claim for Reckless and Gross Mismanagement

Finally, Delaware law does not recognize an independent cause of action for gross mismanagement or abuse of control separate and apart from a breach of fiduciary duty claim. *See Albert v. Alex. Brown Mgmt. Servs., Inc.*, 2004 WL 2050527, at *6 (Del. Super. Sept. 15, 2004) ("[A] claim that a corporate manager acted with gross negligence is the same as a claim that she breached her fiduciary duty of care.") (citing *McMullin v. Beran*, 765 A.2d 910, 921 (Del. 2000) (noting that director liability for breaching the duty of care is predicated upon concepts of gross negligence.)); *see also In re Zoran Corp. Deriv. Litig.*, 511 F. Supp. 2d 986,

1019 (N.D. Cal. 2007) (dismissing claims for gross mismanagement and abuse of control under Delaware law because "these claims are often considered a repackaging of claims for breach of fiduciary duties instead of being a separate tort"); *Continuing Creditors' Comm. of Star Telecommunications., Inc. v. Edgecomb*, 385 F. Supp. 2d 449, 464 (D. Del. 2004) ("'claim that a corporate manager [or director] acted with gross negligence is the same as a claim that she breached her fiduciary duty of care'" (citation omitted)). Thus, for the same reasons that Plaintiffs fail to state a claim for breach of fiduciary duty, *see supra* Points IV.A–B, Plaintiffs' purported claims for "reckless and gross mismanagement" must be dismissed.

CONCLUSION

For the reasons set forth above in Point I, this action should be dismissed or stayed in favor of the consolidated shareholder derivative action now pending in the United States District Court for the Southern District of New York. In the alternative, as shown above in Point II, this action should be dismissed under Court of Chancery Rule 23.1 because plaintiffs failed to make a pre-suit demand and do not plead adequately demand futility. Finally, as set forth in Points III and IV, above, the Complaint should be dismissed under Court of Chancery Rule 12(b)(6) for failure to state a claim.

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Dated: December 4, 2008