IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

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

PLAINTIFFS' ANSWERING BRIEF IN OPPOSITION TO DEFENDANTS' MOTION TO DISMISS OR STAY THIS ACTION OR, IN THE ALTERNATIVE, TO DISMISS THE CONSOLIDATED SECOND AMENDED DERIVATIVE COMPLAINT

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I. PRELIMINARY STATEMENT

This derivative action arises from defendants' utter failure to monitor and control Citigroup, Inc.'s ("Citigroup" or the "Company") exposure to the subprime lending market in spite of known market risks. One need look only as far as the 2007 comments of defendant Charles Prince, Citigroup's former Chief Executive Officer and Chairman of the Board, when he bluntly acknowledged the gathering storm warnings and the Board's determination to continue sailing into trouble: "[w]hen the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing." Of course, the music did eventually stop, liquidity dried up and Citigroup was forced to realize the consequences of its risky and short term profit-driven behavior. As a result of the defendants' conscious failure to monitor and manage such risks, and their continued focus on short-term profits in exchange for long-term viability, the Company's balance sheet was decimated by writedowns, forcing it to raise capital from numerous sources, causing Citigroup's stock price to drop approximately 90% and ultimately necessitating a lifeline directly from U.S. taxpayers to keep the Company afloat.

Defendants' motion to stay this action ("Motion to Stay") in favor of a purportedly parallel action in Federal Court (the "New York Action") or, in the alternative, to dismiss ("Motion to Dismiss;" together, "Motion to Dismiss or Stay") the consolidated derivative actions in this Court (the "Delaware Action") should be denied.

- ***First***, defendants are estopped from moving to stay in favor of the New York Action because they previously engaged in the prosecution of the Delaware Action.
- ***Second***, defendants' motion to stay should be denied in any event because they have not demonstrated the overwhelming hardship needed to make their *forum non conveniens* argument. In addition, this Court has a substantial interest in ensuring the

consistent interpretation and enforcement of its corporate law (particularly here, where the violations have been so egregious and have had profound negative effects on the nation's economy), the Delaware Action is further advanced (both procedurally and substantively) than the New York Action, and the Delaware Action differs substantially from the New York Action because only the Delaware Action sets forth a detailed *Caremark* claim and includes particularized demand futility allegations.

- ***Third***, the Delaware Action adequately alleges that a pre-suit demand on the Board would have been futile.[1] In fact, a majority of the relevant Board members were specifically charged with oversight of Citigroup's exposure to risk but either did not make a good faith attempt to follow the procedures put in place or failed to assure that adequate and proper corporate information and reporting systems existed that would enable them to be fully informed regarding Citigroup's risk to the subprime mortgage market.[2]

- ***Fourth***, plaintiffs have also adequately alleged demand futility for claims involving waste, including defendant Prince's multi-million dollar "retirement" package and the Board's approval of an overpriced stock repurchase. Each of the alleged acts are not subject to the protections afforded by the business judgment rule and constituted a "give away" and irrational squandering of corporate assets.

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[1] Because the standard under Rule 12(b)(6) is less stringent than under Rule 23.1, a complaint that survives a motion to dismiss pursuant to Rule 23.1 will also survive a 12(b)(6) motion to dismiss.

[2] A majority of the relevant Board members also face a substantial likelihood of liability related to Citigroup's violation of FASB accounting standards and disclosures.

- ***Fifth***, Section 102(b)(7) does not shield defendants' misconduct. The Consolidated Second Amended Derivative Complaint ("Complaint") alleges conduct by defendants that falls squarely within the Court's definition of directorial failure to act in good faith, constituting a breach of the non-exculpable, non-indemnifiable duty of loyalty.

For these reasons, the Court should deny defendants' Motion to Dismiss or Stay.[3]

[3] Submitted concurrently herewith is the Transmittal Affidavit of Tiffany J. Cramer and exhibits thereto, which are cited herein as "Cramer Aff. Ex. ____."

II. STATEMENT OF FACTS

A. BACKGROUND OF CITIGROUP'S INVOLVEMENT IN THE SUBPRIME MORTGAGE MARKET

Nominal Defendant Citigroup is a diversified global financial services holding company whose businesses provide a broad range of financial services to consumers and corporate customers. ¶ 1.[4] Since at least as early as 2006, defendants[5] have caused and/or allowed Citigroup to engage in massive subprime lending on an unprecedented scale.[6] ¶ 65. In fact, the Company became one of the biggest players in the lucrative world of risky collateralized debt obligations ("CDOs") through its involvement in subprime lending.[7] ¶¶ 65-66. The Individual Defendants caused Citigroup to become substantially involved in the risky subprime mortgage market despite risk-related reforms announced earlier this decade in connection with prior reckless and improper activities as described herein. In fact, by the time the housing bubble inevitably burst, a staggering 43% of Citigroup's equity was tied up in subprime related assets, including $43 billion in credit derivative products. The Company was also exposed to massive consumer debt issues. ¶ 4.

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[4] Paragraph references to the Complaint are referred to herein as "¶ ___."

[5] Each of the defendants ("Individual Defendants") is a current or former director or officer of Citigroup. Defendants C. Michael Armstrong, Alain J.P. Belda, George David, Kenneth T. Derr, John M. Deutch, Andrew M. Liveris, Anne M. Mulcahy, Richard D. Parsons, Roberto Hernandez Ramirez, Judith Rodin, Robert E. Rubin, Robert L. Ryan and Franklin A. Thomas constitute the board for demand futility purposes (the "Director Defendants" or the "Board").

[6] "Subprime" generally refers to borrowers who do not qualify for prime interest rates because they exhibit one or more of the following characteristics: weak credit histories; previous charge-offs, judgments, or bankruptcies; low credit scores; high debt-burden ratios; or high loan-to-value ratios. *Id.*

[7] CDOs are repackaged pools of lower-rated securities, backed by subprime loans, into tranches with different levels of risk and return. *Id.*

Citigroup's $55 billion subprime exposure was in two separate areas of the Company's Securities & Banking Unit. ¶ 69. The first portion totaled $11.7 billion and included securities tied to subprime loans that were being held until they could be added to debt pools for investors. *Id.* The second portion included $43 billion of super-senior securities, which are portions of CDOs primarily backed by subprime residential mortgage backed security ("RMBS") collateral.[8] *Id.*

Citigroup was also exposed to the subprime mortgage market through structured investment vehicles ("SIVs").[9] Citigroup placed under-performing and/or non-performing assets in off balance sheet SIVs without full disclosure of risks associated with this practice, including the real possibility that Citigroup was ultimately responsible to stabilize the SIVs either through cash infusions or by recapturing the SIVs' assets should they fail. *Id*. Although SIVs historically had underlying assets that were relatively low risk, Citigroup took advantage of short term profits by purchasing riskier borrowings such as home equity loans. ¶ 72. In fact, Citigroup's SIVs invested heavily in subprime loans at this time. However, once the subprime mortgage crisis was fully revealed to the investing public, investors were no longer willing to purchase commercial

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[8] Citigroup created a CDO by acquiring an inventory of asset-backed securities and subsequently selling rights to the cash flow from the securities in a number of tranches rated by credit risk. ¶ 66. Citigroup then profited from the fees it charged to manage the CDO. *Id.* In addition to Citigroup's involvement with conventional CDOs backed by subprime mortgages, Citigroup also allowed a buyer of the CDOs to sell them back at their original value to Citigroup (so-called "liquidity puts"). ¶ 67.

[9] An SIV is a type of complex bond market investment originally created to help banks finance low-risk assets such as credit card loans. ¶ 71. To set up an SIV, banks borrow cash by selling commercial paper to investors and use the proceeds to purchase bundles of high quality loans. *Id.* Investors buy the commercial paper at a discount from face value and expect to hold it for 30, 60 or 90 days, at which point the investor receives the full face value of a note.

paper from SIVs saddled with billions of dollars worth of risky assets. ¶ 68, 95-97. Because the SIVs owed money to commercial paper holders and the SIVs were unable to raise money by selling new commercial paper, the usually very liquid commercial paper market became illiquid, causing serious funding concerns for SIVs. ¶¶ 95-97. Due to the uncertainty of funding for certain SIVs, Citigroup was forced to sell their assets at fire-sale prices to pay off debts. *Id.* Despite the extraordinary risks associated with subprime lending, the Individual Defendants sought after the increased profits at the expense of Citigroup's long-term viability – all in the face of a growing concern that such practices were highly risky and would likely lead to significant losses. ¶ 72.

1. Red Flags Within The Industry Were Readily Available To The Individual Defendants

Starting in at least the middle of 2005, a plethora of reports warning of the impending bursting of the housing bubble and its certain effects on mortgages and subprime mortgage backed securities were readily available to the defendants, especially the "financial experts" on the Board's Audit and Risk Management Committee ("ARM Committee").[10] These reports raised red flags and warning signs about the then-impending burst, notably:

- *May 27, 2005*: Economist Paul Krugman of the *New York Times* saw "signs that America's housing market, like the stock market at the end of the last decade, is approaching the final, feverish stages of a speculative bubble."

- *June 16, 2005*: *The Economist* print edition: "We have been warning for some time that the price of housing was rising at an alarming rate all around the globe, including in America. Now that others have noticed as well, the day of reckoning is closer at hand. It is not going to be pretty. How the current housing boom ends could decide the course of the entire world economy over the next few years."

[10] The ARM Committee members are defendants Armstrong, David, Deutch, Liveris, Mucahy, Rodin and Ryan, constituting a majority of Citigroup's Board (7 of the Board's 13 members). Each of these members were considered "audit committee financial experts," as that term is defined by the SEC, during the relevant time period. (*See* Section II. B. *infra*).

- *December 2005*: Financial Accounting Standards Board ("FASB") Chairman issued an unusual six-page "reminder" to both investors and preparers that warned investments in subprime mortgages were risky and categorized non-traditional mortgages that were packaged as CDOs backed by RMBS as "ticking time bombs" that "started to explode."

- *September 13, 2006*: The Senate Banking Committee heard testimony from "leading economists" as to the economic ramifications of the housing bubble.

- *October 23, 2006*: *Bloomberg* reported on weakening real estate trends.

- *January 30, 2007:* J.P. Morgan's CEO stated that "defaults are rising at J.P. Morgan 'a little bit,'" adding, "'home equity is subject to deterioration' from a recession, but that the bank is well positioned to sustain a downturn in the economy. The bank has largely exited the subprime lending area."

¶ 73. In addition, beginning in February 2007, numerous subprime mortgage lenders began filing for bankruptcy and subprime mortgages packaged into securities began experiencing increasing levels of delinquency. ¶ 74.

Despite the red flags described above as well as numerous other market-based red flags described in the Complaint, the Individual Defendants continued to cause Citigroup to heavily and recklessly invest in the subprime market. For example, in March 2007, Citigroup purchased over $2.7 billion in subprime loans from Accredited Home Lenders at one of its "fire sales." ¶¶ 77, 178, 191, 214, 224. The Individual Defendants also facilitated the Company's purchase of the wholesale mortgage and lending payment collection assets of Ameriquest Mortgage Company, the United States' largest subprime lender as of 2005, on September 1, 2007. *Id.*

2. Citigroup's Prior Egregious Conduct and Failed Risk Reforms Served As Additional Red Flags

The Individual Defendants' failure to control Citigroup's exposure to subprime lending was especially indefensible because of the Company's past involvement in the Enron debacle (in addition to several other financial scandals). ¶¶ 45-64. Citigroup helped finance transactions that allowed Enron to mask its true financial position and present positive financial results to investors. ¶ 48. Citigroup helped Enron by using "pre-pay" transactions that enabled Enron to

categorize loans as financial transactions and entered into special purpose entities ("SPEs") with Enron. ¶ 49. On July 23, 2003, the SEC filed a public administrative proceeding detailing Citigroup's role in both Enron's and Dynegy Inc.'s accounting fraud. ¶ 50. The SEC proceeding charged that Citigroup knew or should have known that various disguised loans violated Sections 10 (b) and 21C of the Exchange Act. ¶ 51. On the same day, Citigroup settled the SEC proceeding, announcing new risk management procedures purportedly designed to prevent such behavior from threatening the Company again, including new guidelines for the use of special purpose vehicles and the use of tax sensitive financial products. ¶¶ 55-56. Citigroup entered into a similar agreement with the Federal Reserve Board. ¶¶ 57-58. Also on July 23, 2003, Citigroup announced that it had previously agreed to alter its risk and reporting practices in August 2002 "to make sure that investors are readily able to understand the financial impact of transactions that Citigroup participates in." ¶ 54. Prior to the Enron-related conduct, Citigroup became the target of an FTC investigation in 2001 and was charged with predatory lending practices. ¶ 60. The FTC charges led to a $215 million settlement in 2002. *Id.*[11] Despite this 2002 settlement, Citigroup was once again penalized for predatory lending practices in 2004. ¶ 61.

It is now obvious that Citigroup's oversight mechanisms and reported risk reforms were either inadequate or consciously ignored: the Individual Defendants recklessly exposed the Company once again when the residential mortgage market offered the opportunity for quick riches. Each of the Individual Defendants abandoned and abdicated his or her responsibilities and

[11] Specifically, Citigroup agreed to revise its written credit risk management program to address complex structured finance transactions. ¶ 58. The revised program would: (a) evaluate the effectiveness of Citigroup's then-current risk management program; (b) ensure the fundamental elements of the credit risk program; (c) ensure that credit risk makers have all necessary information; and (d) analyze when risk identification mechanisms were adequate and effectively managed risk. *Id.*

fiduciary duties with regard to prudently managing the assets and business of Citigroup in a manner consistent with the operations of a publicly held corporation, especially in light of the Company's prior egregious acts and claimed reforms. ¶ 12.

Former SEC Chairman Arthur Levitt compared Citigroup's involvement in the subprime mortgage market to the Enron collapse. ¶ 130. Like Enron, whose off-balance sheet special purpose entities eventually led to its demise, Citigroup failed to disclose the SIVs holding subprime debt on their balance sheets. *Id*. Levitt went on to state, "[t]hese banks claim these entities were separate. . . [i]f so, then why are billions of dollars being spent bailing out these companies? Evidently, they were not as separate as they claimed in their accounting." *Id.* Just two days before Levitt's comments, on November 5, 2007, the SEC announced it was investigating the propriety of Citigroup's accounting for its SIVs. *Id*.

The Board's conscious disregard of the red flags described above was recently confirmed in an article in *The New York Times*. Eric Dash and Julie Creswell, *Citigroup Saw No Red Flags Even as It Made Bolder Bets*, NEW YORK TIMES (Nov. 23, 2008) (Cramer Aff. Ex. 1). The article revealed a string of inadequacies in Citigroup's risk management and control practices, including:

- In 2005, the Federal Reserve took the unusual step or preventing Citigroup from making any additional acquisitions until it corrected trading and banking oversight mechanisms;

- Until at least September 2007, Defendant Prince, Citigroup's CEO, turned a blind eye towards the Company's ownership of approximately $43 billion in mortgage-related assets and the consequences of such a dramatic exposure to a rapidly eroding asset. Neither Prince nor anyone else at Citigroup questioned the ever-expanding exposure to mortgage-related securities because Prince never confronted the risks associated with such an exposure;

- Defendants Prince and Rubin, a Citigroup executive and Board member, played pivotal roles by creating and repeatedly supporting risky strategies designed to take advantage of short-term profits at the expense of the Company's long-term viability and safety. For example, Prince pressured certain employees to create additional CDOs to increase earnings;

- Citigroup risk managers lacked clear lines of reporting. In one instance, risk managers reported to several different managers, creating a conflict of interest by giving the head of

trading influence over risk managers. One senior risk officer was a long-time friend with a subordinate, raising concerns about the independence of the Company's risk control practices;

- Citigroup's risk management process was overly reliant on a single individual, Senior Risk Officer Bushnell, rather than employing a traditional system designed to guard against excess risk. Risk managers were tied too closely with those they were purportedly monitoring;

- It was not until late 2007 that the Company dispatched a risk-management team to rigorously examine the Company's exposure to mortgage-related holdings;

- Citigroup's risk models did not account for the possibility of a national housing downturn;

- Citigroup executives expressed few concerns about the Company's exposure to mortgage-linked securities even after Bear Stearns was negatively impacted;

- Early in 2008, the Federal Reserve chastised Citigroup for its poor oversight and risk controls in a report it sent to the Company. The Company reportedly took steps to overhaul its risk management procedures as a consequence of the Federal Reserve's review; and

- Citigroup's new chief risk officer admitted that "a change in culture is required at Citi" after he was named to the post in mid-2008.[12]

As plaintiffs argue herein, the repeated conscious disregard of these risk factors constitute egregious violations of defendants' fiduciary duties under Delaware law.

B. THE AUDIT AND RISK MANAGEMENT COMMITTEE'S DUTIES AND RESPONSIBILITIES

The members of the ARM Committee (each a member of the Board) are liable for their utter abdication of the duties of loyalty and oversight vested in them by the Company and its stockholders. ¶¶ 183-93. During the period of alleged wrongdoing each of the members of the

[12] As discussed more fully below, because defendants have gone overboard in submitting and relying on documents outside the Complaint, and while plaintiffs stand on the well-pled allegations of the Complaint, to the extent the Court considers such materials it should give similar consideration to the *New York Times* article which submitted herewith.

ARM Committee were considered audit committee financial experts as that term is defined by the SEC. ¶¶ 183-84.

The ARM Committee was responsible for assisting the Board in overseeing and monitoring: (i) the integrity of Citigroup's financial statements and controls; (ii) the performance of the Company's internal audit function; (iii) the annual independent integrated audit of Citigroup's consolidated financial statements and internal control over financial reporting . . . ; (iv) policy standards and guidelines for risk assessment and risk management; and (v) the compliance by Citigroup with legal and regulatory requirements, including Citigroup's disclosure controls and procedures. ¶ 186. In carrying out these enumerated duties, the ARM Committee was required to:

- Evaluate Citigroup's internal control structure and procedures for financial reporting and review management's conclusions about the efficacy of such internal controls and procedures, including any significant deficiencies or material weaknesses in such controls or procedures;

- Review and discuss management's assessment of the effectiveness of Citigroup's internal control structure and procedures for financial reporting and the independent auditors' attestation to, and report on, management's control assessment related to Section 404 of the Sarbanes-Oxley Act of 2002;

- Discuss with management Citigroup's major credit, market, liquidity and operational risk exposures and the steps management has taken to monitor and control such exposures including Citigroup's risk assessment and risk management policies;

- Review and discuss reports from the independent auditors concerning, *inter alia*, critical accounting policies, alternative treatments of financial information within generally accepted accounting principles;

- Review and discuss the Company's reserves, regulatory and accounting initiatives, as well as off-balance sheet structures, and their effect on Citigroup's financial statements; and accounting policies used in the preparation of Citigroup's financial statements; and

- Review and discuss quarterly and annual audited financial statements, earnings press releases and earnings guidance.

¶ 187. As detailed in the Complaint, the ARM Committee repeated failed to carry out the duties and responsibilities set forth in its Charter. ¶¶ 186-87.

C. THE INDIVIDUAL DEFENDANTS FAILED TO COMPLY WITH FASB ACCOUNTING STANDARDS

The Individual Defendants issued false and misleading public statements that did not comport with generally accepted accounting principles ("GAAP") due to their failure to take any steps to consider and account for the subprime lending crisis. ¶ 80. The announcements served to mask and conceal Citigroup's exposure to the subprime market crisis and omitted information concerning the Company's exposure to subprime credit, off-balance sheet entities and other credit-specific problems. *Id.*

For example, FASB provisions apply to the accounting and disclosures required for CDOs, SIVs and VIEs.[13] Citigroup utterly failed to follow these required provisions, such as:

- SFAS 5 - liquidity puts and other similar credit enhancements in Citigroup's interests with its VIEs represented significant contingent liabilities that should have been accounted for, but were not. Citigroup failed to disclose that it was reasonably possible losses could arise from these contractual obligations until the third quarter 2007;

- FIN 45 - a company must recognize a liability at the inception of a guarantee even if it is not probable that payments will be required under the guarantee. Citigroup should have booked a liability with regard to its guarantees under its liquidity puts whether or not it was probable that Citigroup would have to make payments under those agreements at the inception of the guarantees; and

- SFAS 107 - Citigroup was obligated to disclose in its financial statements the fair value of financial instruments, including liquidity puts, CDOs and SIVs. As is painfully clear now, Citigroup failed to disclose that it was guaranteeing hundreds of billions of dollars in assets that were underwritten by risky subprime mortgages and that many of those assets were increasingly becoming illiquid and difficult to price.

¶¶ 160-173.

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[13] The FASB establishes standards of financial reporting and accounting governing the preparation of financial reports. ¶ 160. These reports are officially recognized as authorities by the SEC and American Institute of Certified Public Accountants. *Id.* The FASB issues statements of Financial Accounting Standards ("SFAS"), which set forth actual standards, a summary of research, and a basis for the FASB's conclusions. *Id.* The FASB also issues Financial Interpretations ("FINs") that interpret certain SFASs. *Id.*

As a further consequence, the Management Discussion & Analysis ("MD&A") portion of Citigroup's financial statements failed to comport with standard accounting practices. ¶ 168. In fact, Citigroup and the Board failed to adhere to the SEC's requirements regarding disclosures of off-balance sheet arrangements (such as VIEs, CDOs and SIVs) in the MD&A section because they failed to disclose the existence of the liquidity puts until November 2007. *Id.* Especially egregious was the conduct of the ARM Committee (comprising a majority of the members of the Citigroup Board) which is specifically charged with reviewing and discussing with management the Company's off-balance sheet structures, their effect on the financial statements, and the MD&A section before its inclusion in Citigroup's 10-Ks and 10-Qs. *Id.*

D. THE INDIVIDUAL DEFENDANTS ALLOWED PRINCE TO WALK AWAY WITH A WINDFALL RETIREMENT

On November 4, 2007, Citigroup announced that defendant Prince elected to resign as Chairman and CEO effective November 5, 2007 ("Letter Agreement"). ¶ 119. Under the terms of the Letter Agreement, Price "retired" from Citigroup with an astounding $68 million, including his salary and accumulated stockholdings. ¶ 122. Despite the massive exposure to the subprime mortgage market – exposing Citigroup to billions of dollars in losses – Prince also received a bonus of $12.5 million in 2007, compared with the previous year's bonus of $13.8 million.[14] *Id.* Under the Letter Agreement, Prince was entitled to an office, an administrative assistant, and a car with a driver for the lesser of 5 years or until he commenced full time employment with another employer. ¶ 124.

[14] In 2006, unlike 2007, Citigroup's stock price never dipped below $45.05 and Prince was employed as CEO for the entire year. ¶ 212.

E. DEFENDANTS' FAILURE TO ADEQUATELY MANAGE CITIGROUP'S RISK IN THE SUBPRIME MARKET CAUSED CATASTROPHIC DAMAGES TO THE COMPANY

Beginning in October 2007, the consequences of the Individual Defendants' failure to adequately manage the subprime market risks at Citigroup were realized. ¶ 107. The following events demonstrate the losses to date at Citigroup that were a direct consequence of the Individual Defendants' failure of oversight:

- *October 1, 2007*: Citigroup announced it would write-down approximately $1.4 billion on funded and unfunded highly leveraged finance commitments. ¶ 104.

- *October 15, 2007*: Citigroup issued a press release reporting a net income of $2.38 billion, a 57% decline from the Company's prior year results. ¶ 108.

- *November 4, 2007*: Citigroup announced significant declines on the fair value of the approximately $55 billion in the Company's U.S. subprime-related direct exposures, and estimated that further write downs would be between $8 and $11 billion. ¶ 115.

- *November 6, 2007*: Citigroup disclosed that it provided $7.6 billion of emergency financing to the seven SIVs the Company operated after they were unable to repay maturing debt. ¶ 126. The SIVs drew on the $10 billion of so-called committed liquidity provided by Citigroup. *Id.* On December 13, 2007, however, Citigroup was forced to bail out seven of its affiliated SIVs by bringing $49 billion in assets onto its balance sheet and take full responsibility for the SIVs' $49 billion worth of assets. ¶¶ 135-136.

- *January 15, 2008*: Citigroup announced it would take an additional $18.1 billion write-down for the forth quarter 2007 and a quarterly loss of $9.83 billion. ¶ 138. Citigroup also lowered its dividend to $0.32 per share, a 40% decline from the Company's previous dividend disbursement. ¶ 139.

- By March 2008, Citigroup shares traded below book value and the Company announced that it would lay off an additional 200 employees, bringing Citigroup's total layoff since the beginning of the subprime market crisis to more than 6,000. ¶¶ 145-146.

- *July 18, 2008*: Citigroup announced it lost $2.5 billion in the second quarter, largely caused by $7.2 billion of write-downs of Citigroup's investments in mortgages and other loans. ¶ 157.

Gary Crittenden, Citigroup's current chief financial officer, recognized that "different teams responsible for monitoring CDO holdings didn't spot the ballooning risks until it was too late to sell the CDOs at reasonable prices or to hedge the banks exposure: 'The [cross-pollination]

between the credit-risk team and the market-risk team was not as strong as it needed to be.'" ¶ 142. Erik R. Sirri, the head of the SEC's market regulation division, echoed this statement in November 2007 when he stated that securities firms and banks sold "too many lottery tickets" tied to U.S. mortgages and failed to adequately inform themselves of their growing risks. ¶ 131. According to Sirri, the financial companies had "a significant risk management failure" on the CDOs and often relied on prices from "other market participants" instead of internal assessments to gauge the worth of super-senior CDOs, leaving them "flying blind." *Id.* The failure of risk management has also led to shareholders criticizing the Board. ¶ 147. According to *The Wall Street Journal*, shareholders and some executives at Citigroup "[were] frustrated with the board's failure to sound the alarm as the bank piled up big risks in the years before the credit crunch hit." *Id.*

Citigroup has also been forced to accept numerous capital infusions to stay afloat. On November 26, 2007, Citigroup was forced to accept a $7.5 billion capital infusion from the Abu Dhabi government. ¶ 128. Several months later, Citigroup announced that it required an additional cash infusion of $12.5 billion through the sale of convertible preferred securities in a private offering. The private offering included a $6.88 billion investment from the government of Singapore Investment Corporation Pte Ltd as well as investments from Capital Research Global Investors; Capital World Investors; the Kuwait Investment Authority; the New Jersey Division of Investment; HRH Prince Alwaleed bin Talal bin Abdulaziz Alsaud; and Sanford I. Weill (former CEO of Citigroup) and The Weill Family Foundation. ¶ 140. On April 21, 2008 Citigroup raised $6 billion from a preferred stock offering. ¶ 151. On April 30, 2008, Citigroup announced that it planned to raise at least $3 billion by selling common stock. ¶ 152.

F. DEMAND FUTILITY ALLEGATIONS

Demand on the Board is excused because a majority of the Board members face a substantial likelihood of liability. A majority of the Board members were members of the Company's ARM Committee (each qualifying as an "audit committee financial expert" as defined by the SEC) failed or refused to carry out their obligations pursuant to the ARM Committee Charter. ¶¶ 183-193. A majority of the Board members were also members of the Board during the Company's prior exposure in the Enron debacle. Moreover, as discussed *infra*, demand is excused because the Citigroup Board can enjoy no exculpation from the Company's Corporate Charter and 8 Del. C. § 102(b)(7). *See, e.g. In re Emerging Comms. Inc. S'holder Litig.*, 2004 Del. Ch. LEXIS 70 (May 3, 2004) (discussion *infra* Section IV.A.2.i.).

Specifically, demand is excused because the ARM Committee members – representing a majority of the Board – repeatedly failed to:

- adequately manage Citigroup's exposure to, among other things, risky mortgages backed by CDOs, and failed to monitor and/or oversee the Company's operations in order adequately manage the risk in the face of the red flags described above. ¶¶ 186-193.
- oversee the Company's operations by failing to scrutinize Citigroup's exposure to risk, including subprime mortgages and the steps being taken to monitor the risk and control of such exposure. ¶ 191. Because of the ARM Committee and Board's failure of oversight, the Company continued to invest in subprime mortgages by purchasing assets during the midst of the subprime crisis from two subprime lenders, Accredited Home Lenders and Ameriquest Mortgage Company. *Id.*
- ensure that the Company's financial reporting comported with GAAP and FASB standards. ¶¶ 192-93.
- correct any misstatements in the MD&A portions of Citigroup's 10-K and 10-Qs. ¶ 190.

Demand is also excused because nine out of thirteen Board members were members of the Board during the Company's prior reckless exposure in Enron and other financial debacles. These same Board members oversaw the Company's ensuing risk management reforms developed to prevent such exposure from endangering the Company again.[15] ¶ 179.

Demand is excused because each Board member is liable for waste for:

- allowing the purchase of subprime loans at a fire sale in March 2007. ¶ 196.
- authorizing and not suspending the Company's share repurchase program in the first quarter 2007 which resulted in the Company buying back over $645 million worth of the Company's shares at artificially inflated prices. ¶ 194.
- approving the Letter Agreement between the Company and Prince. *Id.*

Therefore, demand is excused because a majority of the Board failed to exercise oversight, knew they were not discharging their fiduciary obligations and demonstrated a conscious disregard for their responsibilities.

[15] Specifically, defendants Armstrong, Belda, David, Derr, Deutch, Parsons, Ramirez, Rubin and Thomas were members of the Citigroup Board of Directors during this time.

III. PROCEDURAL POSTURE

A. THE DELAWARE ACTION

The Delaware Action has moved at a procedurally faster pace than the New York Action since the inception of the lawsuits. On November 7, 2007, the first Delaware Action was filed by Carole Kops. Cramer Aff. Ex. 2, *Kops v. Prince*, C.A. No. 3338-CC. The remainder of the complaints in the Delaware Action were filed on the following dates: December 28, 2007, (Cramer Aff. Ex. 3, *Montgomery County Employees Ret. Fund v. Prince*, C.A. No. 3436-CC); January 9, 2008, (Cramer Aff. Ex. 4, *Sheldon M. Pekin Irrevocable Descendants' Trust Dated 10/01/01 v. Prince*, C.A. No. 3456-CC); and January 29, 2008; (Cramer Aff. Ex. 5, *City of New Orleans Employees' Retirement Sys. v. Prince*, C.A. No. 3504-CC).

On February 4, 2008, plaintiffs in the Delaware Action filed a Stipulation Regarding Further Proceedings and Order of Consolidation, seeking consolidation of the four related derivative actions and appointment of lead counsel. LexisNexis Transaction ID# 18433885. The Court granted the Order of Consolidation on February 5, 2008. LexisNexis Transaction ID# 18451620. On February 19, 2008, plaintiffs filed a Consolidated Amended Derivative Complaint. LexisNexis Transaction ID# 18615388. On February 27, 2008, plaintiffs served defendants with Plaintiffs' First Set of Document Requests Directed to All Defendants.

On April 21, 2008, defendants filed their Motion to Dismiss the Consolidated Amended Derivative Complaint. LexisNexis Transaction ID# 19495304. Notably, defendants did not file a motion to stay the Delaware Action when they filed their April 21, 2008 Motion to Dismiss. On August 21, 2008, plaintiffs filed a Motion for Leave to Amend their Consolidated Amended Derivative Complaint along with the Complaint. LexisNexis Transaction ID# 21126257. On September 15, 2008, the parties jointly filed a Stipulation and Order regarding plaintiffs' Complaint. LexisNexis Transaction ID# 21522569. Under the Stipulation, defendants agreed to

not oppose Plaintiffs' Motion for Leave to Amend and also agreed to move or otherwise respond to the Complaint on or before November 4, 2008.

Defendants filed their Motion to Dismiss or Stay plaintiffs' Complaint on November 4, 2008. LexisNexis Transaction ID# 22320789. The Motion to Dismiss or Stay was the first indication given by defendants of their intention to seek a stay of the Delaware Action in favor or the New York Action. At no time between filing their April 21, 2008 Motion to Dismiss and filing their Motion to Dismiss or Stay on November 4, 2008 did defendants request or even suggest that the Delaware Action be stayed.

On November 7, 2008, the parties entered into a Stipulation and Proposed Order regarding the briefing schedule on defendants' Second Motion to Dismiss. LexisNexis Transaction ID# 22374430. Under the terms of the Court's Order dated November 12, 2008 granting the parties' proposed briefing schedule, (LexisNexis Transaction ID# 22424052), defendants filed their Opening Brief in Support of their Motion to Dismiss or Stay on December 4, 2008. Under the Court's January 2, 2009 Order, (LexisNexis Transaction ID # 23129825), plaintiffs must file their Answering Brief in Opposition to Defendants' Motion to Dismiss or Stay by January 7, 2009 and defendants must file their Reply Brief in Support of their Motion to Dismiss or Stay by January 28, 2009.

B. THE NEW YORK ACTION

On November 6, 2007, just one day before the first Delaware Action was filed, the first New York Action, *Harris v. Prince*, No. 07-CV 9841-SHS, was filed on behalf of Citigroup by an individual stockholder in the United States District Court for the Southern District of New

York.[16] Cramer Aff. Ex. 6. The remainder of the New York Actions were filed also by individual stockholders on the following dates: November 8, 2007, (Cramer Aff. Ex. 7, *Cinotto v. Prince*, No. 07-CV 9900-SHS); November 14, 2007, (Cramer Aff. Ex. 8, *Nathanson v. Prince*, No. 07 CV 10333-SHS); November 15, 2008, (Cramer Aff. Ex. 9, *Cohen v. Prince* No. 07 CV 10344-SHS); December 26, 2007, Cramer Aff. Ex. 10, *Ryan v. Prince*, No. 07 CV 11581-SHS). Notably, unlike the Delaware Action there are no institutional investors among the plaintiffs in the New York Action.

In January and early February 2008, the plaintiffs in the New York Action briefed their motions to consolidate and appointment of lead counsel. While the plaintiffs in the Delaware Action were actively litigating their case, the New York Action remained dormant, from February 2008 until August 2008. On August 22, 2008 – after defendants had already agreed to the prosecution of the derivative litigation in Delaware and after the Complaint was already on file in the Delaware Action – the New York Action finally stirred when the New York Court ordered the cases consolidated for all purposes. Cramer Aff. Ex. 11, Consolidation Order. On September 23, 2008, the court appointed lead plaintiffs and lead counsel in the New York Action, and ordered the following schedule: within 45 days from the date of the Order plaintiffs shall file a consolidated complaint; within 45 days from plaintiffs' filing of a consolidated complaint defendants shall move or otherwise respond; within 45 days from the service of defendants' motion the New York plaintiffs shall file and serve their opposition to any motion to dismiss; and within 20 days from the service of the New York plaintiffs' opposition defendants shall file a reply. Cramer Aff. Ex. 12, New York Case Management Order No. 2.

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[16] The New York Action includes a greater number of defendants than the Delaware Action because of the extensive insider trading allegations.

Under the terms of the Case Management Order, the New York plaintiffs filed their Consolidated Derivative Action Complaint on November 10, 2008. ("Federal Consolidated Complaint" or "Fed. Consol. Compl.", Cramer Aff. Ex. 13). Because of an extension, plaintiffs in the New York Action must file their opposition to defendants' motion by February 9, 2009 and defendants must file their reply by March 2, 2009.

As detailed herein, while the New York Action was brought derivatively, the claims asserted are securities fraud first and foremost, and even the pendent state law claims are essentially fraud claims masquerading as state law claims. The Federal Consolidated Complaint focuses its allegations on the defendants' insider trading and public misstatements and omissions. *Id.* at ¶¶ 4, 67-87.[17] Importantly, the New York Action fails to assert squarely, let alone with any particularity, the primary claim asserted in the Delaware Action – the Board's failure of oversight under *Caremark* and its progeny.

Unlike the extensive and detailed demand futility allegations in the Delaware Action, the New York Action's demand futility allegations contain only passing reference to internal controls at Citigroup in the context of improper financial disclosures. *See generally* Fed. Consol. Compl. ¶¶103-128. For example, the New York Action's recently amended demand futility allegations regarding the ARM Committee amount to a mere one page and three paragraphs. *Id.* at ¶ 120-122. The Federal Consolidated Complaint only lists the "purpose" of the ARM Committee (which is also included in the Delaware Action), and, unlike the Delaware Action, does not go into specific details regarding the ARM Committee's duties and responsibilities. Cramer Aff. Ex.

[17] Interestingly, the demand futility section in the New York Action also references the securities fraud litigation by stating, "In addition, as alleged in the securities fraud litigation, each of Board Member Defendants authorized and/or allowed the Company to release inaccurate statements directly to the public or securities analysis that were then made available and disseminated to shareholders." *Id.* at ¶109.

13, Fed. Consol. Compl. at ¶120. The only allegation that the Federal Consolidated Complaint contains regarding the ARM Committee, besides listing the ARM Committee's purpose, is limited to the following:

> Defendants Armstrong, David, Deutch, Liveris, Mulcahy, Rodin and Ryan, breached their fiduciary duty of loyalty because the Audit Committee participated in the preparation of improper financial statements and earnings press releases that contained false and/or misleading material information. Furthermore, the Audit Committee (and Board) failed to ensure that the Company implemented requisite internal controls over its lending practices to prevent the Company from making loans to unqualified persons. Finally, these Defendants had the opportunity, but failed to review and correct Prince's improper financial statements and other public disclosures.

Id. at 121.

Because the New York Action is also not as procedurally advanced as the Delaware Action, makes only passing reference to the Board's failure to implement controls, and contains only bare bones demand futility allegations, this Court should adjudicate the important claims asserting egregious violations of fiduciary duty having a profound deleterious effect on this Country's economy.

IV. ARGUMENT

A. THIS ACTION SHOULD NOT BE DISMISSED OR STAYED IN FAVOR OF LITIGATION PENDING IN THE SOUTHERN DISTRICT OF NEW YORK

1. Defendants are Estopped from Moving to Stay Given Their Prior Consent to This Jurisdiction And Consequent Defense of the Action in Delaware

Defendants, because of their prior consent to this jurisdiction, are now estopped from moving to stay. *See* David A. Drexler, Lewis Black, Jr. & A. Gilchrist Sparks, III, 1 *Delaware Corporation Law and Practice* § 11-1[a], at 11-7 (2008). Any prejudicial effect of the Delaware Action proceeding without a stay is of defendants' own making and strategic design. Defendants had full knowledge of the New York Action but chose not to move to stay the Delaware Action in April 2008 (concurrent with their original Motion to Dismiss).

2. Defendants Cannot Overcome Their Burden of Showing Overwhelming Hardship in Their Motion to Stay

The doctrine of *forum non conveniens* applies to defendants' Motion to Stay because the Delaware Action and New York Actions were contemporaneously filed.[18] The *forum non conveniens* factors are:

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[18] Defendants do not dispute that the actions were contemporaneously filed, or genuinely dispute that the doctrine of *forum non conveniens* applies to their Motion to Stay. Defendants alternatively assert the *McWane* analysis in summary fashion. Defendants' Opening Brief in Support of their Motion to Dismiss or Stay ("Op. Br.") at 16. Under *McWane*, the Court considers the following factors: whether there is a (1) first filed prior pending action in another jurisdiction, (2) that involves similar parties and issues, and (3) that court is capable of rendering prompt and complete justice. *McWane, Cast Iron Pipe Corp. v. McDowell-Wellman Eng'g Co.*, 263 A.2d 281, 283 (Del. 1970). Even if *McWane* did apply to Defendants' Motion to Stay – which it does not – there is no basis in law for this Court to dismiss or Stay this case under *McWane*.

When there is no "first-filed" action, as is the case here, the cases will be treated as contemporaneously filed and the doctrine of *forum non conveniens* will apply. *Ryan*, 918 A.2d at 349-50. Additionally, defendants' claim that the New York and Delaware Actions involve the (continued…)

> (1) the applicability of Delaware law, (2) the relative ease of access of proof, (3) the availability of compulsory process for witnesses, (4) the pendency or non-pendency of a similar action or actions in another jurisdiction, (5) the possibility of a need to view the premises,[19] and (6) all other practical considerations that would make the trial easy, expeditious, and inexpensive.

Ryan v. Gifford, 918 A.2d 341, 351 (Del. Ch. 2007) (internal quotations and citation omitted).

Even if this Court does not find that defendants are estopped from seeking a stay of the Delaware action, defendants cannot meet their burden of showing "overwhelming hardship" if held to their consent to litigate in Delaware. Under Delaware law, "a party seeking to stay or dismiss on the grounds of *forum non conveniens* must demonstrate that litigating in Delaware would subject it to *overwhelming* hardship." *Id.* Therefore, a Delaware Court will dismiss or stay an action only in the rare case in which the combination and weight of the *forum non conveniens* factors balance "overwhelmingly" in favor of defendants. *See Ryan*, 918 A.2d at 351; *Sprint Nextel Corp. v. iPCS Inc.*, 2008 Del. Ch. LEXIS 90, at *65 (July 14, 2008) ("Delaware courts consistently uphold a plaintiffs choice of forum except in rare cases.") (internal quotations

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(…continued)

same parties and issues (Op. Br. at 15-16) is erroneous. As set forth herein, the New York derivative claims are essentially repackaged securities claims, with a focus on insider trading and alleged misstatements and omissions.

A Delaware court is also in the best position to expeditiously resolve questions of Delaware law. This Court has recently held, "when deciding a motion to stay in the context of a representative lawsuit, the 'paramount interest' the court must protect is ensuring that a corporation's stockholders receive 'fair and consistent enforcement of their rights. . .'" *Brandin*, 941 A.2d at 1023-24. A fair analysis of this *McWane* factor shows Citigroup will receive the most prompt and complete justice by pursuing its claims in Delaware. As former Chancellor Allen wrote, on questions of Delaware corporation law, this Court "by reason of its constant exposure, has developed a 'feel' that might not be duplicated elsewhere." *Hoover Indus., Inc. v. Chase*, 1988 Del. Ch. LEXIS 98, at *12 (July 13, 1988). This is even more important where, as here, the litigation involves novel or unsettled issues of Delaware law. (*See* Section III.A.2.i., *infra*). Therefore, for these reasons, *McWane* does not counsel in favor of a stay of the Delaware Action.

[19] Plaintiffs do not believe the fifth factor is applicable to this litigation.

and citation omitted). Clearly, defendants' prior defense of the Delaware Action negates any claim of hardship.

"[B]are allegations of inconvenience without a particularized showing of hardships relied upon" will not be sufficient for a dismissal on the basis of *forum non conveniens*. *Taylor v. LSI Logic Corp.*, 689 A.2d 1196, 1199 (Del. 1997). *See also Aveta, Inc. v. Colon*, 942 A.2d 603, 608-09 (Del. Ch. 2008) (finding that the "Court need not and should not compare Delaware to the alternative forum to determine 'which is the more appropriate location for this dispute to proceed.' The Court's search must remain for overwhelming hardship.") (citation omitted); *Ryan*, 918 A.2d at 351 ("motions to dismiss a plaintiff's choice of forum are not granted for defendants' mere convenience"). Defendants do not – and cannot – point to anything with particularity which would cause them to suffer "overwhelming hardship" if the Delaware Action continues.

Defendants argue that the Delaware Action should be stayed because, among other reasons, "New York is . . . the center of gravity" and because securities fraud and ERISA actions against Citigroup are also pending before Judge Stein in the Southern District of New York. Op. Br. at 16-17. However, defendants do not acknowledge that in order to obtain the relief they seek, they must overcome the burden of showing overwhelming hardship. Their silence is telling– defendants ignore the standard precisely because they have not met it, nor could they under the circumstances of this case.[20]

[20] Even a lesser balancing standard weighs against staying the Delaware Action. The *forum non conveniens* factors do not weigh in support a stay of the Delaware Action. Delaware would be "the more easy, expeditious, and inexpensive" jurisdiction in which to litigate. *HFTP Invs., LLC v. ARIAD Pharms., Inc.*, 752 A.2d 115, 122 (Del. Ch. 1999). In *HFTP Investments*, the Court found that, even under a lesser standard, the factors tipped in favor of litigating in Delaware, especially with Delaware's strong interest in protecting the rights of investors of a corporation formed under its General Corporation Law. *Id.* (finding that it was "ironic" that ARIAD, having voluntarily chosen to incorporate in Delaware, would proclaim that it was (continued…)

i. Applicability of Delaware Law and Delaware's Interest in Deciding Cases Involving Important or Novel Issues of Delaware Law In the Context of the Subprime Crisis

Delaware Courts strongly prefer to apply their own law rather than leave such interpretations to a foreign jurisdiction, especially when important or novel issues of Delaware law are involved. In addition, Delaware Courts have a paramount interest in deciding cases implicating important issues of Delaware corporate governance law in light of current market conditions, which here are on a profound and global scale. *See County of York Employees Ret. Plan v. Merrill Lynch & Co., Inc.*, 2008 Del. Ch. LEXIS 162, at *12 (Oct. 28, 2008) (finding that even if an action does not necessarily raise "novel" questions of Delaware law, an action might still "implicate important issues of Delaware corporate governance law" that weigh against staying a Delaware action); *Ryan*, 918 A.2d at 349-50 (noting that Delaware's interest "in actively overseeing the conduct of those owing fiduciary duties to shareholders of Delaware Corporations…increases greatly in actions addressing novel issues"); *Topps*, 924 A.2d at 960 (concluding that Delaware Courts "have long been chary about [staying a case] when a case involves important question of our law in an emerging area").

Delaware law solely governs the fiduciary duty claims in this litigation. Citigroup is incorporated in Delaware, and its officers and directors breached fiduciary duties owed to the Company's stockholders. This alone weighs heavily in favor of denying defendants' Motion to Stay, as Delaware has a "substantial interest in overseeing the conduct of those owing fiduciary

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(…continued)

inconvenient for them to litigate in this state). The same is true here. As discussed herein, this Court is able to provide prompt, complete justice on Delaware corporation law, especially with important or novel issues of Delaware law at stake. *Hoover Indus., Inc. v. Chase*, 1988 Del. Ch. LEXIS 98, at *12; *Merrill Lynch*, 2008 Del. Ch. LEXIS 162, at *17.

duties to shareholders of Delaware corporations." *Armstrong v. Pomerance*, 423 A.2d 174, 177 (Del. 1980); *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69, 89 (1987) ("No principle of corporation law and practice is more firmly established than a state's authority to regulate domestic corporations."). *See also Ryan*, 918 A.2d at 351 (finding that because Delaware law controls, "the applicability of Delaware law clearly favor[ed] denial of the motion"); *NRG Barriers, Inc. v. Jelin*, 1996 Del. Ch. LEXIS 81, at *17 (July 1, 1996) ("Even if the California action and the Delaware action share the same parties and issues, I should not stay the Delaware action. Delaware has too vested an interest in this matter to turn away."). Given this Court's expertise, plaintiffs in the Delaware Action, including two institutions all having substantial holdings of Citigroup stock, chose to litigate their claims in Delaware and not in New York and their choice of forum should be respected.[21]

The Court has not hesitated to seize control of sizeable derivative cases involving vast corporate governance issues, even where class and derivative cases are pending elsewhere that would seem to suggest a different center of gravity. Indeed, Vice Chancellor Strine did so in 2005 with the *American International Group Inc. Consolidated Derivative Litigation*, C.A. No. 769-VCS (May 31, 2005) (Tr.) (Cramer Aff. Ex. 14), where not only were there federal securities cases and a parallel derivative case pending in New York, but there were SEC, Department of Justice, New York Attorney General and other state regulatory proceedings pending in New York as well. (*See generally Id.* at 71-84). Vice Chancellor Strine concluded that Delaware should retain control of the corporate governance issues on which it had expertise, and decided to keep the derivative action moving forward in Delaware (the New York derivative action was

[21] The plaintiffs in the New York Action, by comparison, are all individuals.

ultimately stayed), while coordinating with the United States District Court for the Southern District of New York to make sure the proceedings did not interfere with each other. (*Id.* at 79:6-15).

Recent case law supports plaintiffs' position.

In *Ryan v. Gifford*, a case alleging options backdating, the Court denied defendants' motion to stay in favor of litigation filed in California Federal Court. 918 A.2d at 350. In *Ryan*, the Delaware action was filed a few weeks after the first two cases were filed in California, where the actions were already consolidated with a leadership structure in place. *Id.* at 347. Both the California and Delaware actions asserted similar allegations, but the California action also included Section 10(b) and Rule 10b-5 claims. *Id.* The Court, applying the *forum non conveniens* factors, refused to stay the Delaware action because Delaware had a strong interest in deciding novel and important issues regarding options backdating and directors' fiduciary duties. *Id.* at 350. Because the backdating issues in the case involved important issues of Delaware corporate governance, a Delaware Court, by deciding those issues, could "remove doubt regarding Delaware law and avoid inconsistencies that might arise in the event other state or federal courts, in applying Delaware law, reach differing conclusions." *Id.* at 350.[22] Here, as in *Ryan*, the Delaware Action should not be stayed simply because the New York Action was filed a one day before the Delaware Action and includes federal claims. Moreover, the New York Action does not even raise fairly the *Caremark* claim asserted in the Delaware Action. And, notably, just as in *Ryan*, the Court will be asked to decide important and novel issues of Delaware law regarding fiduciary duties, including the issue of what constitutes the appropriate oversight

[22] Notably, the Court gave no deference to the fact that the California action also included Section 10(b) and Rule 10b-5 claims. *Id.*

duties owed by a director who is qualified as a financial expert as defined by the SEC and charged with non-delegable duties by the audit committee charter.[23]

Although the principles of *Caremark* have been addressed by this Court, the subject matter involved here "implicate[s] important issues of Delaware corporate governance law" that should first be addressed by this Court given the current market condition. *See Merrill Lynch*, 2008 Del. Ch. LEXIS 162, at *12. Moreover, this Court has only briefly discussed the appropriate oversight owed by a financial expert in *In re Emerging Communications, Inc. Shareholders Litigation*, 2004 Del. Ch. LEXIS 70 (May 3, 2004). In *Emerging*, the Court suggested that the duty of oversight owed by such "financial experts" may be higher than for a board member who does not have similar financial expertise. In *Emerging*, the Court found a director defendant, who had significant expertise in finance as a securities analyst, liable for approving a transaction at an unfair merger price. *Id.* at *143-*144. As a securities analyst, the director "possessed a specialized financial expertise, and an ability to understand [the company's] intrinsic value, that was unique to the … board members." *Id*. The other non-conflicted directors could "plausibly argue that they voted for the transaction in reliance on [the financial advisor's] opinion that the merger term price was fair." *Id.* at *145. As to the financial expert director whose status provided him with superior knowledge, however, "that argument would be implausible." *Id.* Therefore, the Court found that the financial expert director was not

[23] Plaintiffs' claim regarding Citigroup's ARM Committee is distinguishable from *Wood v. Baum*, 953 A.2d 136 (Del. 2008) and *Rattner v. Bidzos*, 2003 Del. Ch. LEXIS 103 (Sept. 30, 2003). In *Wood* and *Rattner*, plaintiffs argued that audit committee membership alone was a sufficient basis to infer the requisite scienter or culpable state of mind. *Wood*, 953 A.2d at 142. In contrast, the Delaware Action alleges that the ARM Committee members are liable not only because of their membership on the Committee and expertise, but also because they consciously disregarded, or turned a blind eye to, the risks involved in the subprime mortgage market, despite specific charges to oversee risk under their Charter. ¶¶ 186-193.

inoculated from liability under 8 Del. C. § 102(b)(7), because the burden falls upon the director to show that "[his] failure to withstand an entire fairness analysis is *exclusively* attributable to a violation of the duty of care." *Id.* at *146 (*citing Emerald Partners v. Berlin*, 787 A.2d 85, 98 (Del. 2001) (quotation omitted)).

Likewise, in *Merrill Lynch*, the Court refused to stay a Delaware action in favor of New York where, like here, the case raised important corporate governance questions concerning the recent subprime-driven market collapse, where there was limited Delaware case law available. *Id.* at *12. The defendants moved to stay the Delaware action in favor of a derivative litigation on behalf of Merrill Lynch pending in New York for over a year that had just been amended to add claims to a merger between Merrill Lynch and Bank of America. *Id.* at *5-6. Defendants in *Merrill Lynch* argued that the circumstances of that case were similar to *In re The Bear Stearns Cos. Inc., S'holder Litig.*, 2008 Del. Ch. LEXIS 46 (Apr. 9, 2008), in which the Court had granted a stay in favor of pending New York litigation. *Id.* at *15. In *Merrill Lynch*, however, the Court found that none of the *Bear Stearns* "*sui generis*" factors were present.[24] The Court in *Merrill Lynch* also found that the New York action's merger claims were not as procedurally advanced as the Delaware action, the Delaware action was more fulsomely pled and the Delaware action would be able to proceed on a more expedited basis.[25] *Id.* at *12-*17.

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[24] The Court found that the Delaware and New York actions against Merrill Lynch were contemporaneously filed because the merger claims were added at a later date and were not sufficiently related to the derivative claims. *Id.* at *9.

[25] The Court also applied the *forum non conveniens* factors to defendants' motion to stay in *Bear Stearns*, where two parallel actions in Delaware and New York challenged the proposed merger between Bear Stearns and JP Morgan. *Bear Stearns*, 2008 Del. Ch. LEXIS 46. The Court noted that the important legal issues involved in the context of the Bear Stearns-JP Morgan merger would normally weigh against a stay of the Delaware action. *Id.* at *23. However, because of the "*sui generis*" nature of the circumstances surrounding the case, the *forum non* (continued…)

Here, just as in *Merrill Lynch*, the Delaware Action implicates important issues of Delaware law in the context of current market conditions. In addition, the Delaware Action is not only more fulsomely pled than the New York Action but also includes a *Caremark* claim. And, the Delaware Action is procedurally advanced. Finally, because the Delaware Action implicates important issues in the subprime crisis and consequent effects, where there is limited Delaware law, this Court should deny defendants' Motion to Stay.

Given all of these factors, the same factors relied on in *Merrill Lynch*, plaintiffs' choice of forum should be allowed. The important and unsettled issues of Delaware law implicated in the Delaware Action are of paramount importance to the State of Delaware, its corporations and practitioners of corporate law.

ii. Relative Ease of Access to Proof and Availability of Compulsory Process for Witnesses

The second and third *forum non conveniens* factors – ease of access to proof and availability of compulsory process for witnesses – are of relative unimportance and do not counsel in favor of a stay. *Brandin v. Deason*, 941 A.2d 1020, 1025-26 (Del. Ch. 2007) (finding

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(…continued)

conveniens analysis tipped the scales in favor of staying the Delaware action. *Id.* at *23-24. These "*sui generis*" factors included the fact that Bear Stearns, due to a liquidity crisis, was on a rapid downward spiral which would have resulted in insolvency had JP Morgan not stepped in and acquired it with the help of the Federal Reserve and Department of Treasury. *Id.* at *25-*26. Moreover, the Court noted that the New York action in *Bear Stearns* was procedurally further advanced than the Delaware action, which had not proceeded past the filing of a complaint and a motion to stay. *Id.* at *26. In *In re Ambac Financial Group, Inc. Shareholders Deriv. Litig.*, C.A. No. 3521-VCL (Letter Op.) (Dec. 30, 2008), the Court stayed the Delaware action in favor of pending litigation in the Southern District of New York primarily because the "demand excusal allegations in that complaint [bore] a strong resemblance" to those in the Delaware action. *Id.* The Court also found that the New York action was more procedurally advanced. *Id. Ambac* is not applicable here.

that these factors "deserve relatively little weight in the Court's analysis. . ."). "[M]ost corporate litigation in the Court of Chancery involves companies with documents and witnesses located outside of Delaware." 918 A.2d at 351. These factors are relatively inconsequential in light of modern realities of technology and travel. *Rapoport v. Litig. Trust of MDIP, Inc.*, 2005 Del. Ch. LEXIS 180, at *27 (Del. Ch. Nov. 23, 2005). Further, as defendants "and all experienced corporate practitioners know, the discovery will take place in a location convenient to the party producing the documents and being deposed." *In re: The Topps Company S'holders Litig.*, 924 A.2d 951, 961 (Del. Ch. 2007).

Defendants fail to identify any documents they will be unable to produce or any necessary witnesses not subject to compulsory process. *Ryan* 918 A.2d at 351. As the Court in *Brandin v. Deason* stated, the Court "stands ready to grant commissions to take . . . depositions should it prove necessary." 941 A.2d at 1026; *Merrill Lynch.*, 2008 Del. Ch. LEXIS 162, at *12. If defendants' logic regarding the location of the witnesses and documents were followed, Delaware Courts would rarely hear issues of Delaware law. The substantial majority of companies incorporated in Delaware maintains their headquarters outside the state and have many employees who are not immediately subject to compulsory process.[26] Further, "[D]efendants do

[26] *Royal Indemnity Co. v. Gen. Motors Corp.*, 2005 WL 1952933 (Del. Super. Ct. July 26, 2005) and *AZURIX Corp. v. Synagro Techs., Inc.*, 2000 Del. Ch. LEXIS 25 (Del. Ch. Feb. 3, 2000), cited by defendants in support of their position that the Delaware Action should be stayed because almost all documents and witnesses are located in New York, are inapposite. *Royal Indemnity* involved an insurance coverage dispute between Royal and General Motors. 2005 WL 1952933, at *1. In the Delaware action, Royal sought a declaratory judgment to see whether it had any obligation to GM in relation to certain insurance; the Michigan Action sought a declaratory judgment that GM was entitled to coverage from GM. *Id.* The Court found that the fact that important evidence and employee witnesses were located in Michigan weighed in favor of a stay. *Id.* at *9.

AZURIX involved merger discussions between Azurix and Synagro Technologies that turned sour. 2000 Del. Ch. LEXIS 25, at *1. Azurix filed suit in the Court of Chancery; Synagro (continued…)

not even attempt to argue that this court is inconvenient for them." *Topps*, 924 A.2d at 961. Therefore, this factor does not weigh in favor of a stay.

iii. Pendency or Non-Pendency of Similar Actions

Defendants' assertion that the Delaware and New York Actions are essentially the same (Op. Br. at 15-16) is incorrect – the two cases are fundamentally different. There is and never has been a substantial overlap between the two actions – not as originally filed or as amended.

The Delaware Action primarily asserts a *Caremark* claim and demonstrates that demand would be futile in that context. The New York Action, on the other hand, sounds in securities fraud and insider trading, and does not set forth similar demand futility allegations.

Notably, the Court of Chancery has held that the adequacy of the complaint is an important factor in the *forum non conveniens* analysis. *Ryan*, 918 A.2d at 349. *See also Biondi v. Scrushy*, 820 A.2d 1148, 1159 (Del. Ch. 2003) (refusing to stay a later-filed Delaware action because the complaint in the earlier-filed Alabama action was substandard compared to the Delaware action). The adequacy of the complaint is such an important factor that the "Court will, in certain instances, grant or deny a stay based on this factor alone." *Ryan*, 918 A.2d at 349. A comparison of the pleadings in the New York Action and the Delaware Action weighs against a stay.

(…continued)

sued Azurix in a Texas Court regarding the same disputes one business day later. *Id.* at *2. The Court found that because "[m]yriad boxes of documents" and almost all relevant witnesses were located in Texas that this weighed in favor of a stay. *Id.* at *18. In addition, Texas law applied to the dispute. *Id.* at *16-17. *Royal Indemnity* & *AZURIX* are the exception, rather than the rule. Delaware law applies to this case (which alone weighs against a stay) and, if necessary, the Court will likely grant commissions for witnesses who do not reside in this state. *See Ryan*, 918 A.2d at 315.

The allegations in the Delaware Action detail the ARM Committee members' failure of oversight under *Caremark* despite their financial expertise and specific duties under their Charter; the Individual Defendants' breaches of fiduciary duties; the Individual Defendants' conscious failure to detect, prevent and/or halt the significant risks associated with the Company's exposure to the subprime crisis; the Individual Defendants' failure to adequately monitor Citigroup's financial reporting; and the Individual Defendants' prior reckless conduct in connection with Enron and other financial debacles. ¶¶ 174-199.

The Delaware Action also includes a publicly-available letter from the CtW Investment Group (a representative group whose affiliates are substantial long-term Citigroup shareholders) to defendant Mulcahy, concerning her candidacy for a continuing position on Citigroup's Board along with the Company's failure, despite numerous red flags concerning the subprime mortgage market, to manage Citigroup's mortgage-related risk. ¶ 137. This letter goes directly to demand futility – the Board, despite red flags waving in their faces, either did not make a good faith attempt to follow procedures put in place, or failed to assure that an adequate and proper corporate information system existed that would enable them to be fully informed regarding Citigroup's risk to the subprime mortgage market. *See* Section III.B., *infra*.

By contrast, the allegations underlying both the securities fraud and pendent state law claims in the New York Action are premised on defendants' misrepresentations and omissions regarding Citigroup's true condition and insider sales.[27] The Federal Consolidated Complaint's

[27] Indeed, the Federal Consolidated Complaint sets forth approximately 16 pages (out of a total 67) of allegations under the heading "Defendants Caused The Company To Issue False And Misleading Statements," where the complaint copies, verbatim, Citigroup's press releases during the relevant time period. Cramer Aff. Ex. 13, Federal Consol. Compl. at 26-42. The original New York complaints also included a section titled, "Reasons The Statements Were Improper," (continued…)

demand futility allegations focus on defendants' alleged misstatements and violations of securities laws and do not include a detailed *Caremark* claim. Cramer Aff. Ex. 13, Fed. Consol. Compl., ¶¶ 103-128.[28] In fact, the Federal Consolidated Complaint includes a mere three paragraphs regarding the ARM Committee's oversight responsibilities in the context of improper financial disclosures.[29] *Id.* at ¶¶ 120-122. The Federal Consolidated Complaint also does not include the publicly-available letter from the CtW Group to defendant Mulcahy.

Notwithstanding access to the pleadings in the Delaware Action, the New York Action also fails to include, among other things, the particularized allegations included in the Delaware Action regarding Citigroup's prior conduct in connection with the Enron debacle and other financial scandals earlier this decade. ¶¶ 45-64. The Delaware Action details Citigroup's Enron-related conduct, the Company's purported risk management reforms, settlements with the SEC and Federal Reserve Board and Citigroup's penalties related to its predatory lending practices. *Id.*

The Federal Consolidated Complaint, by comparison, contains only one footnote regarding Citigroup's risk management reforms and one paragraph about Citigroup's Enron-

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(…continued)

which is a hallmark of securities fraud class actions. *See* Cramer Aff. Ex. 6, *Harris v. Prince* at pg. 33; Cramer Aff. Ex. 8, *Nathanson v. Prince*, at pg. 34.

[28] The demand futility section of the Federal Consolidated Complaint even refers to the securities fraud litigation. *Id.* at ¶ 109 ("as alleged in the securities fraud litigation, each of Board Member Defendants authorized and/or allowed the Company to release inaccurate statements. . . .").

[29] The original New York complaints barely mention the ARM Committee, and only one of the original New York complaints contained any allegations regarding the ARM Committee's duties and responsibilities. *See* Cramer Aff. Ex. 10, *Ryan v. Prince* at ¶¶ 88-90.

related conduct. Cramer Aff. Ex. 13, Fed. Consol. Compl. at ¶ 48; ¶48 fn.1. These appear to have been added as an afterthought, as the New York Action had the benefit of seeing the Delaware Action's Second Consolidated Amended Complaint before filing the Federal Consolidated Complaint.

In addition, defendants' argument that New York can somehow provide more complete justice because securities fraud and ERISA actions are also pending in the Southern District of New York before Judge Stein, (Op. Br. at 17), is misleading. The fact that the securities fraud and ERISA actions are pending in New York cannot – and should not – weigh in this Court's determination of whether or not the Delaware Action should be stayed in favor of the New York Action. Based on the stark differences between the Delaware Action and the New York Action, the two cannot be characterized as similar under the *forum non conveniens* analysis. [30]

[30] Further, defendants' argument (Op. Br. at 16) that the Southern District of New York is the only court capable of granting complete relief is without merit. As stated herein, the New York Action differs substantially from the Delaware Action, and includes bare allegations of a *Caremark* claim, at best. The cases cited by defendants in support of this proposition, *Issen & Settler v. GCS Enters., Inc.*, 1981 WL 15131 (Del. Ch. Dec. 7, 1981) and *Schnell v. Porta Sys. Corp.*, 1994 WL 148276 (Del. Ch. Apr. 12, 1994) have no application to the circumstances of this case and do not support a stay. In *Issen*, two shareholders filed suit in Illinois District Court challenging a merger that cashed out the minority stockholders. 1981 WL 15131 at *1. Shortly after the plaintiffs amended their complaint in the District Court, the same plaintiffs filed an action in Delaware, alleging essentially the same violations of Delaware law relating to mergers as were then before the District Court. *Id*. at *2. The Court, applying *McWane*, exercised its discretion and stayed the later-filed Delaware action because the claims asserted in the Delaware action "essentially mirrored" those in the Illinois District Court. *Id.*

In *Schnell*, the Delaware action was filed nearly three weeks after the first filed suit in the Eastern District of New York. 1994 WL 148276 at *1. The allegations in both actions were centered around fraudulent misrepresentation, concealment and nondisclosure. *Id.* The Court found that the causes of action in both cases derived from the same basic allegations of fraud due to the defendants' material misrepresentations. *Id*. at *4. As detailed above, the Delaware and New York Actions involve substantially different allegations and causes of action.

iv. All Other Practical Considerations – The Delaware Action is Procedurally Further Advanced

Delaware Courts also consider the procedural status of a separate pending action as compared to the Delaware action. *See Ryan*, 918 A.2d at 351; *In re Topps Co. S'holders Litig.*, 924 A.2d 951, 957-58 (Del. Ch. 2007) (when the Delaware action has proceeded more briskly, other considerations, such as Delaware's interest in ensuring the consistent interpretation and enforcement of its corporation law become paramount). This factor weighs heavily against a stay, as the Delaware Action is procedurally further advanced than the New York Action, which stood dormant for six months while the Delaware Action was being prosecuted. *See* Section III.B., *supra*.

B. DEFENDANTS' MOTION TO DISMISS SHOULD BE DENIED BECAUSE ANY PRE-SUIT DEMAND ON THE BOARD WOULD HAVE BEEN FUTILE

This Court has consistently held that "a 'substantial likelihood' of personal liability prevents a director from impartially considering a demand" under Court of Chancery Rule 23.1. *Seminaris v. Landa*, 662 A.2d 1350, 1354 (Del. Ch. 1995), *quoting Rales*, 634 A.2d at 936. *See Guttman v. Huang*, 823 A.2d 492, 500 (Del. Ch. 2003). Thus, where the face of a complaint pleads a claim of breach of fiduciary duty "with sufficient particularity to permit the court to *reasonably* reach the required conclusion," courts will conclude that defendants face a substantial likelihood of liability and the complaint will survive a motion to dismiss pursuant to Rule 23.1. *In re Baxter Int'l*, 654 A.2d 1268, 1270 (Del. Ch. 1995) (emphasis added). Only a reasonable inference is required. *See id*.[31] Here, at least a majority of the Director Defendants, by virtue of having sat on the Board during previous Enron-related financial debacles (9 out of 13 directors) and/or by virtue of their membership on the ARM Committee (7 out of 13 director), face a substantial likelihood of personal liability stemming from their failure of oversight and causing Citigroup to improperly value assets in violation of accounting rules.

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[31] Plaintiffs agree that the *Rales* standard governs the pending failure of oversight claim. Because plaintiffs' disclosure claims relate to actions taken by the Board, these claims are subject to the *Aronson* standard. *See Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984). However, it is still proper to review demand futility under the "substantial likelihood of liability" standard, because if plaintiffs demonstrate reasonable doubt as to whether or not the Board acted on an honest and good faith belief that the action was in the best interests of the corporation, the subsequent threat of liability to the directors required to act on the demand is sufficiently substantial to cast a reasonable doubt over their actions. *See Guttman v. Huang*, 823 A.2d 492, 500 (Del. Ch. 2003).

1. The Director Defendants' Failure of Oversight Subjects Them to a Substantial Likelihood of Liability

"*Caremark* articulates the necessary conditions predicate for director oversight liability: (a) the directors utterly failed to implement any reporting or information system or controls; *or* (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention." *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006) (emphasis in original). Thus, for a derivative complaint to withstand a motion to dismiss, it must allege "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 – [thereby] establish[ing] the lack of good faith that is a necessary condition to liability." *Stone*, 911 A.2d at 372, (quoting *Caremark*, 698 A.2d at 971).

A majority of the Director Defendants were responsible for overseeing and monitoring the Company's exposure to risk (¶ 185) and, as a consequence, since at least as early as 2005 the Director Defendants were aware of or should have been aware of the many red flags concerning the subprime mortgage crisis that were becoming painfully evident to both market professionals and Citigroup's competitors alike. ¶¶ 8, 73-74. Citigroup's directors should have been especially conscious of such warning signs in light of the Company's previous Enron-related fines and claimed corrective risk management measures implemented in 2003 and 2004 (¶¶ 54-58, 185), during which time a majority of the Director Defendants were serving on the Citigroup Board.[32] ¶¶ 11, 45, 47-55. In fact, in November 2008, *The New York Times* identified a string of

[32] Defendants Armstrong, Belda, David, Derr, Deutch, Parsons, Ramirez, Rubin and Thomas were members of the Board during Citigroup's Enron-related conduct. ¶¶ 16-27.

disturbing inadequacies in Citigroup's risk management and control practices including poor risk reporting mechanisms and improper risk modeling that ultimately forced the Federal Reserve to chastise Citigroup for its poor oversight and risk controls in a report it sent to the Company.[33] *See* Cramer Aff. Ex. 1. Thus, the Director Defendants' conscious disregard of their duties and utter lack of proper supervision and oversight caused the Company to be overexposed to the excessive risk of the subprime mortgage market, resulting in, *inter alia*, billions of dollars worth of losses in its subprime-related investments. ¶¶ 114-17, 138, 157-58. Furthermore, Citigroup executives, including defendant and then-Chairman Prince, knew that liquidity would become a problem, yet kept on "dancing" in spite of these known risks. ¶ 98. Therefore at least half of the members of the Board are disabled because they face a substantial likelihood of liability, excusing demand.

2. A Majority of the Director Defendants Were Charged With Oversight of Citigroup's Risk

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

[33] Defendants have gone far afield in submitting many documents not described or relied upon in the Complaint, including news articles, press releases, market analysts' reports, and stock quotations. Plaintiffs believe that defendants' documents are self-serving and need not be considered on a motion directed to the Complaint, which plaintiffs believe is well-pled. However, if the Court is inclined to consider the defendants' exhibits, the Court should also consider the November 23, 2008 *New York Times* article, entitled "Citigroup Saw No Red Flags Even as It Made Bolder Bets." Cramer Aff. Ex. 1. Further, if the Court considers the defendants' exhibits and treats the motion as one for summary judgment, plaintiffs should be entitled to discovery to more fully develop the record regarding these matters. *Kessler v. Copeland*, 2005 WL 396358, *4-5 (Del. Ch. Feb. 10, 2005) ("[W]hen a motion to dismiss under Court of Chancery Rule 12(b)(6) is converted to a motion for summary judgment due to consideration of extrinsic matters, 'the parties must be given an opportunity to take discovery.'") (quoting *Wal-Mart*, 860 A.2d at 320); *Mann v. Oppenheimer & Co.*, 517 A.2d 1056, 1061 (Del. 1986). *See* Affidavit of Meghan A. Adams Pursuant to Rule 56(f), which is submitted herewith, detailing plaintiffs' need for discovery.

within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance." *Caremark*, 698 A.2d 959, 970 (Del. Ch. 1996). The ARM Committee members were specifically charged with assisting the Board in fulfilling its oversight responsibility relating to the policy standards and guidelines for risk assessment and risk management.[34] ¶ 185. The ARM Committee members, each of whom were financial experts, were specifically tasked with overseeing and understanding the Company's credit, market, liquidity and operational risk exposures and the steps management took to monitor such exposure, including off-balance sheet arrangements. ¶¶ 185-87.

Moreover, each ARM Committee member qualified as an "audit committee financial expert," which required them to have, *inter alia*:

- "(i) an understanding of generally accepted accounting principles and financial statements;
- (ii) the ability to assess the general application of generally accepted accounting principles in connection with the accounting for estimates, accruals and reserves; [and]
- (iii) experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the company's financial statements, or experience actively supervising one or more persons engaged in such activities."

¶ 184.[35]

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[34] Defendants do not deny that a majority of the Director Defendants served on the ARM Committee. ¶ 183.

[35] Defendants erroneously conclude that the Court should not take a director's professional qualifications into consideration. In fact, a director's qualifications are indeed relevant to his or her necessary level of vigilance with respect to red flags. *See In re Emerging Communications, Inc. S'holders Litig.*, 2004 Del. Ch. LEXIS 70, *144-47 (May 3, 2004) (noting that director's financial expertise and knowledge gave the director far less reason to defer to the Special Committee's advisors, and that because the director's actions did not reflect his expertise, the evidence supported a reasonable inference that the director "'consciously and intentionally (continued…)

Despite their responsibilities and qualifications, the ARM Committee members either did not make a good faith attempt to follow the procedures put in place or failed to assure that adequate and proper corporate information and reporting systems existed that would enable them to be fully informed regarding Citigroup's risk to the subprime mortgage market.[36] Instead, the ARM Committee members failed to adequately scrutinize (or turned a blind eye to) Citigroup's exposure to risk, including subprime mortgages and the steps being taken to monitor the risk and control of such exposure in breach of their fiduciary duties. *See David B. Shaev Profit Sharing Account v. Armstrong*, 2006 Del. Ch. LEXIS 33, *15 (Feb. 13, 2006) ("[a] claim that an audit committee or board had notice of serious misconduct and simply failed to investigate, for example, would survive a motion to dismiss, even if the committee or board was well constituted and was otherwise functioning."); *In re Emerging Communications, Inc. S'holders Litig.*, 2004 Del. Ch. LEXIS 70, *144-47 (holding that directors are not entitled to blindly defer to the representations of others). As discussed more fully below, there were many red flags which should have or did in fact alert the ARM Committee members to the excess risks associated with the subprime mortgage market. Nevertheless, under the watch of the Director Defendants, the Company was exposed to unjustifiable risk, suffering significant harm when the subprime market risks were finally and inevitably realized. In fact, the Company was forced to acknowledge

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(…continued)

disregarded' his responsibility to safeguard the minority stockholders from the risk, of which he had unique knowledge . . . amount[ing] to a violation of his duty of loyalty and/or good faith.") (citation omitted).

[36] While plaintiffs have alleged that Citigroup had supervisory mechanisms in place, plaintiffs have in no way "conceded" that Citigroup had *proper* oversight mechanisms in place, and certainly have not conceded that the Director Defendants complied with even their mandated charge under the ARM Committee Charter. *See* Op. Br. at 29.

billions of dollars in losses and to raise billions of dollars in capital to remain afloat. ¶¶ 66-68, 70-72, 114-17, 138, 140, 151, 157-58, 183.

Defendants contend that merely conducting monthly meetings demonstrates the ARM Committee's proper adherence to Citigroup's oversight procedure. Op. Br. at 25-26. However, the number of meetings only highlights the ARM Committee's conscious failure to oversee the Company's operations. For example, despite the ARM Committee's nondelegable charge to discuss critical accounting policies (especially those where management was required to make a judgment call regarding their implementation) and the ARM Committee's many meetings, Citigroup failed to follow the FASB provisions which applied to the accounting and disclosures required for CDOs, SIVs, and VIEs. ¶¶ 160-73.

Indeed, the ARM Committee members, as financial experts, undoubtedly understood and appreciated the risks that the SIVs posed to Citigroup in the event that their contingent liabilities had to be carried on Citigroup's balance sheet. Nonetheless, the ARM Committee members accepted Citigroup's management's representations at face value and failed to ensure that the CDOs, SIVs and VIEs were properly accounted for or disclosed. ¶ 94, 183-93. An example of the Director Defendants' failure to account for risks is the fact that Citigroup was significantly exposed to liquidity puts in November 2007 when an additional $25 billion in commercial paper was brought onto Citigroup's books. ¶¶ 68, 115.

Accordingly, these Director Defendants, comprising a majority of the thirteen Board members (¶ 183), face a substantial likelihood of liability for their breaches of fiduciary duty, making any demand upon them futile. *See Kohls v. Duthie*, 791 A.2d 772, 782-83 (Del. Ch. 2000) (denying the defendants' motion to dismiss under Rule 23.1, reasoning that "the Kenetech board's apparent acceptance of [the CEO's] assertions at face value, without conducting any

independent analysis or seeking independent advice, tend to show a disregard for corporate interests," subjecting them to a substantial likelihood of personal liability).

Defendants point to *David B. Shaev Profit Sharing Account*, a derivative case alleging fraud at Citigroup in relation to Enron and WorldCom, for the proposition that "identical claims against Citigroup's oversight mechanisms" were rejected. Op. Br. at 26-27. However, in *Shaev*, the Court dismissed the action, not because there was no wrongdoing,[37] but because there were no allegations of director knowledge nor any allegations of any red flags. 2006 Del. Ch. LEXIS 33, at *17. The Court found it significant that "[t]he plaintiff [had] concede[d] that the defendants knew nothing about the challenged transaction, [ ] had erected a full set of supervisory mechanisms to oversee the company," and that the plaintiff had not alleged any particularized facts suggesting there were any "red flags" alerting the Board to the potential misconduct with regard to Enron and WorldCom. *Id*. at *17-18. By contrast, while the very same "oversight mechanisms" may have been in place during the subprime mortgage meltdown, Plaintiffs have alleged that such mechanisms were inadequate and improper and have alleged that the Director Defendants were faced with many red flags alerting them to the risks in the subprime mortgage market as well as the problems with Citigroup's control practices and procedures. ¶¶ 45-54, 60-61, 73-74.

3. A Majority of the Director Defendants Systematically Failed to Oversee Citigroup's Risk By Ignoring the Red Flags in the Marketplace and Within the Company

Notwithstanding the claimed risk controls in place and numerous red flags regarding the impending collapse of the subprime mortgage market, the Director Defendants either consciously

[37] Citigroup was forced to pay millions of dollars to settle charges concerning the Company's involvement in the institutionalized, systematic, and creatively planned accounting fraud at Enron. ¶¶ 46, 53.

remained ignorant of the Company's increased exposure to the subprime mortgage market, which was a multi-billion dollar part of Citigroup's business, or failed to investigate the risks related to the same.[38] *See David B. Shaev Profit Sharing Account*, 2006 Del. Ch. LEXIS 33, at *19 (stating that a "director could be found liable for remaining ignorant of a large fraud occurring in plain sight, even if the director is able to show that the company had established a full set of supervisory controls").

Defendants rely on cases rejecting failure-of-oversight derivative claims for demand futility that were 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." *See* Op. Br. at 30. However, plaintiffs have alleged more than just mere "bad results" at Citigroup. *Id.* In stark contrast to the cases cited by defendants, the Complaint contains particularized allegations that excuse demand. The Complaint details the Director Defendants' sustained, systemic failure of oversight and risk management of Citigroup over an extended period of time, despite the Company's previous admonishments by the SEC and the Company's claimed risk control improvements.[39]

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[38] Defendants assert that they may not be "charged with wrongdoing simply for assuming the integrity of employees." Op. Br. at 28. However, as discussed above, directors are not entitled to blindly defer to management and may be found to have failed to act in good faith when their actions (or omissions) to safeguard the company from risk do not reflect their expertise and experience with prior bad acts. *See In re Emerging Communications, Inc. S'holders Litig.*, 2004 Del. Ch. LEXIS 70, *144-47 (May 3, 2004); *McCall v. Scott*, 239 F.3d 808, 821 (6th Cir. 2001).

[39] At a minimum, nine of the thirteen directors on the Citigroup Board (three of whom were members of the ARM Committee during the relevant period) were members of the Board during the Company's prior reckless exposure in connection with Enron and other contemporaneous financial debacles and each was involved in the Company's risk management measures undertaken to prevent such exposure from taking place again. ¶¶ 179, 183. Further, seven of the thirteen directors of the Board were members of the ARM during the relevant period qualified as "audit committee financial experts" as defined by the SEC, and were responsible for oversight (continued…)

i. Red Flags Present in the Market

The Complaint sets forth in detail the numerous red flags concerning the subprime mortgage crisis that the Director Defendants (especially those on the ARM Committee) were or should have been aware of, given their qualifications and charge. ¶ 73-74. Specifically, the Complaint details:

- the steady decline of the housing market and the impact the collapsing bubble would have on mortgages and subprime backed securities since as early as 2005. ¶ 73;
- December 2005 guidance from the FASB staff – "The FASB staff is aware of loan products whose contractual features may increase the exposure of the originator, holder, investor, guarantor, or servicer to risk of nonpayment or realization." ¶ 73; and
- the drastic rise in foreclosure rates starting in 2006. ¶ 74;
- several large subprime lenders reporting substantial losses and filing for bankruptcy starting in 2006. ¶ 74;
- billions of dollars in losses reported by Citigroup's peers, such as Bear Stearns and Merrill Lynch. ¶ 74;
- On November 28, 2007 Erik R. Sirri, the head of the SEC's market regulation division stated that securities firms and banks sold "too many lottery tickets" tied to U.S. mortgages and failed to adequately inform themselves of their growing risks. The financial companies had "a significant risk management failure" on the CDOs and often relied on prices from "other market participants" instead of internal assessments to gauge the worth of super-senior CDOs, leaving them "flying blind" Sirri said. ¶ 131.

Instead of excusing their conduct (Op. Br. at 29-30), the industry-wide crisis that threatened the very existence of many of Citigroup's peers was a red flag waving in the face of

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(…continued)

responsibility relating to the policy standards and guidelines for risk assessment and risk management. ¶¶ 183-184.

the Director Defendants. *See In re Citigroup, Inc. S'holders Litig.*, 2003 Del. Ch. LEXIS 61, *8 (June 5, 2003). Thus, defendants' citation to *In re Mut. Funds Inv. Litig.* is misguided. Although news concerning late trading and market timing practices in the mutual fund industry may have given the trustees notice that their company might be subject to liability, such red flags did not implicate the financial viability and potential existence of the company. 384 F. Supp. 2d 873 (D. Md. 2005). By contrast, the red flags in the marketplace starting in at least 2005 evidenced the subprime market crisis' domino effect, with Citigroup's peers slowly collapsing around them, signaling that Citigroup's future might also be in danger. ¶¶ 73-74.

Further, while defendants argue that the red flags concerning the housing market and the subprime mortgage market did not draw connections to CDO investments (Op. Br. at 30), the Director Defendants should have been sensitive to such red flags given Citigroup's history with predatory lending to subprime borrowers.[40] ¶¶ 60-61. Additionally, it is apparent that the Director Defendants completely disregarded such red flags when Citigroup, under the Director Defendants' watch, purchased over $2.7 billion in subprime loans from Accredited Home Lenders at one of its "fire sales" in March 2007. ¶ 77.

ii. Red Flags Present Within the Company

The Director Defendants should have been especially sensitive to the red flags in the marketplace in light of the Company's prior involvement in the Enron Corporation debacle and other financial scandals earlier in the decade. The opinion in *McCall v. Scott* is instructive on this point. In *McCall* shareholders alleged that directors breached their fiduciary duties in connection

[40] In 2002 Citigroup entered into a settlement with the FTC regarding deceptive lending practice in the subprime market, and despite the 2002 settlement, Citigroup was once again penalized for its predatory lending practices in 2004. ¶ 61. The 2004 settlement included a cease-and-desist order imposed by the Board of Governors of the Federal Reserve System and a $70 million civil penalty. *Id.*

with widespread and systematic health care fraud by certain hospitals, home health agencies, and other facilities. 239 F.3d 808, 813 (6th Cir. 2001). The District Court had dismissed the complaint for failure to sufficiently allege demand futility under Delaware law. *Id*. Reversing the District Court in part, the Sixth Circuit found that the plaintiffs had sufficiently alleged demand futility with respect to their oversight claim. *Id*. at 814. The Court stated that "[a] significant factor in its assessment of the factual allegations was the prior [and relevant] experience of a number of the defendants" of managing a healthcare company that had been previously investigated for, and settled allegations of, similar questionable billing, cost reporting, and marketing practices. *Id*. at 819, 821. After setting out plaintiffs' allegations regarding several red flags which should have alerted the directors of possible wrongdoing, the Court concluded it would be reasonable to infer that, based on their experience, these directors (who served on the company's audit committee) would be sensitive to similar circumstances which had previously prompted investigations. *Id.* at 821.

Nine of the thirteen Director Defendants were members of the Board when Citigroup was involved in Enron and other related financial debacles (¶¶ 45-54) and, consequently, should have been sensitive to the circumstances that prompted these debacles, most notably Citigroup's significant involvement with SIVs. Specifically, Citigroup helped finance transactions that allowed Enron to present positive financial results to investors, masking Enron's true financial condition by characterizing the proceeds from Enron's cash financings as cash from operating (instead of financing) activities on its financial statements. ¶¶ 48, 50. On July 28, 2003, in connection with a public administrative proceeding filed against Citigroup by the SEC related to these transactions, Citigroup agreed to pay a fine of approximately $120 million along with purported new risk-management procedures. ¶ 53-54. The new risk-management procedures were designed to prevent such activity from threatening the Company again, including improved

review and approval of complex structured finance transactions and new guidelines for the use of special purpose vehicles. ¶ 54-56. Citigroup entered into a similar agreement with the Federal Reserve Board in which Citigroup promised to deliver reports detailing its credit and reputational risk management program to address complex finance transactions. ¶ 57.

In fact, the Complaint explains that Citigroup was was forced to pay billions of dollars to settle charges concerning its involvement in the institutionalized, systematic, and creatively planned accounting fraud at Enron. ¶ 45. Citigroup assisted Enron's fraud through "prepay" transactions that enabled Enron to categorize loans as financial transactions and entered into special purpose entities[41] with Enron. ¶ 49. In connection with the Enron-related settlements, the Company agreed to alter its risk and reporting practices in a number of material respects in August 2002 "to make sure that investors are readily able to understand the financial impact of transactions that Citigroup participates in." ¶ 54. In another instance, defendant Prince himself announced that Citigroup "continued to develop and improve the way in which we review and approve complex structured finance transactions." ¶ 55. Finally, Citigroup also agreed to revise its written credit risk management program to address complex structured finance transactions. ¶ 58. The revised program would: (a) evaluate the effectiveness of Citigroup's then-current risk management program; (b) ensure the fundamental elements of the credit risk program; (c) ensure that credit decision-makers possessed all necessary information; and (d) analyze whether risk identification mechanisms were adequate and effectively measured risk. ¶ 58.

[41] A special purpose entity ("SPE") is also referred to as a "bankruptcy remote entity" whose operations are limited to the acquisition of financing specific assets. The SPE is usually a subsidiary company with an asset/liability structure that makes its obligations secure even if the payment goes bankrupt. www.investopedia.com/terms/s/spr.asp. ¶ 50.

In spite of the risk management reforms implemented in connection with the Enron bankruptcy and with knowledge of the liability that such actions could prompt, at least as early as 2006, under the Director Defendants' direction and management, Citigroup invested billions of dollars in subprime loans and subprime RMBS collateral for its CDO portfolios. ¶ 70. The ever-increasing exposure was undertaken in spite of a parade of red-flags concerning the subprime housing market and the ramifications that would ultimately follow. ¶ 73-74. One need look only as far as Citigroup's purchase of over $2.7 billion in subprime loans from Accredited Home Lenders at one of its "fire sales" in March 2007, despite the remarkable number of bankruptcies occurring in the marketplace, among other red flags occurring prior to and immediately after such purchase. ¶ 77. In addition, Citigroup placed subprime loans and subprime RMBS collateral for its CDO portfolios in off-balance sheet SIVs. ¶ 70. Because Citigroup's SIVs invested in subprime loans, many investors were no longer willing to purchase commercial paper from its SIVs. At the same time, the SIVs owed money to commercial paper holders, and because they were unable to raise money by selling new commercial paper, they were forced to sell their assets at fire-sale prices to pay off debts. Consequently, Citigroup's SIVs were on the verge of collapse, subjecting the Company to billions of dollars in liability as a result of investor lawsuits for causing the conduits to issue debt based on materially false and misleading statements. ¶ 95. Given the dislocation in financial markets, the cost of commercial paper increased substantially as LIBOR rose to abnormally high levels. As such, the commercial paper market became illiquid, causing serious funding concerns for SIVs. With the uncertainty of funding for certain SIVs, the assets held by those SIVs would eventually have to be sold at fire sale prices. ¶ 97.

Furthermore, according to *The New York Times*, it was not until September 2007 that the Company belatedly dispatched a risk-management team to rigorously examine the Company's exposure to mortgage related holdings and failed to account for the possibility of a national

housing downturn in its risk models. Cramer Aff. Ex. 1. Early in 2008, the Federal Reserve chastised Citigroup for its poor oversight and risk controls in a report it sent to the Company. *Id.* The Company reportedly took steps to overhaul its risk management procedures as a consequence of the Federal Reserve's review. *Id.*

Major Company investors also chastised the Director Defendants' failure to control the Company's substantial mortgage risks and investments in CDOs until late 2007. ¶ 137. The Company itself *acknowledged* that the teams responsible for monitoring CDO holdings did not spot the ballooning risks associated with such holdings until it was too late to hedge exposure to those risks. ¶ 142. "Citigroup, which has suffered more than $20 billion in losses from mortgage-related woes, now acknowledges that different teams responsible for monitoring CDO holdings didn't spot the ballooning risks until it was too late to sell the CDOs at reasonable prices or to hedge the bank's exposure: 'The [cross-pollination] between the credit-risk team and the market-risk team was not as strong as it needed to be,' Gary Crittenden, Citigroup's current chief financial officer, told analysts in October. 'We have to have more integration between the way those teams operate.'" ¶ 142. Furthermore, according to *The Wall Street Journal*, "The board has been criticized by shareholders and, in private, by some Citigroup executives. They are frustrated with the board's failure to sound the alarm as the bank piled up big risks in the years before the credit crunch hit, saddling Citigroup with more than $20 billion in losses since last summer." ¶ 147. *The Wall Street Journal* also categorized Citigroup as a "poster child for slapdash risk management." ¶ 143. In short, these practices illustrate a sustained and systematic failure of the Board to exercise oversight of the Company's practices. In spite of repeated warnings, the Company took no steps to attempt to assure a reasonable information and reporting system existed and took no steps to timely inform them selves of the risks associated with massive exposure to subprime lending. The failure to do so establishes the lack of good faith that

is a necessary condition to liability. In fact, it was only *after* the Federal Reserve chastised the Company that it finally took steps to rectify its inadequate control system. These allegations are precisely the type necessary to sustain a claim for a breach of the duty of oversight.

Defendants take great pains to try to minimize the applicability of the Company's prior involvement with Enron (Op. Br. at 37-38), but even former SEC Chairman Arthur Levitt compared the meltdown of the subprime mortgage market to the Enron collapse. ¶ 130. Like Enron, whose off-balance sheet SPEs eventually led to its demise, banks such as Citigroup failed to disclose the SIVs on their balance sheets holding subprime debt. ¶ 130. Levitt stated, "[t]hese banks claim these entities were separate . . . [i]f so, then why are billions of dollars being spent bailing out these companies? Evidently, they were not as separate as was claimed in their accounting." *Id*.

Additionally, this Court's prior dismissal of a derivative action against Citigroup directors in connection with Enron matters for failure to plead demand futility has no bearing on the instant case. *See Shaev*, 2006 Del. Ch. LEXIS 33 (Feb. 13, 2006). As discussed above, the factual allegations regarding Citigroup's involvement in the Enron scandal and the resulting investigations and penalties are relevant to the Director Defendants' experience and should have made them "sensitive to the circumstances that prompted the investigation" of the potential misconduct related to Enron and WorldCom. *See McCall*, 239 F.3d at 821.

4. The Director Defendants Were Not Permitted to Make Decisions Causing the Company to Become Involved in Excessive Risk

Defendants' discussion of the permissibility of directors and officers to make aggressive decisions regarding risk misses the mark. *See* Op. Br. at 31. While Delaware law allows directors and officers to make decisions regarding risk, such an allowance assumes that "the process employed was either rational or employed in a *good faith* effort to advance corporate interests." *Caremark*, 698 A.2d at 967 (emphasis in original). However, as discussed above, it

was the Director Defendants' failure of oversight, which is a failure to discharge their fiduciary obligations in good faith, which allowed this behavior to continue within Citigroup. *See Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006) (citations omitted).

5. At Least Half the Director Defendants Face a Substantial Likelihood of Liability Relating to Citigroup's Violation of FASB Accounting Standards

Each of the Director Defendants breached his or her fiduciary duty of loyalty by causing Citigroup to improperly value subprime mortgage related securities and off-balance sheet entities in violation of FASB accounting standards. ¶¶ 80-113, 160-173. As a result, Citigroup issued materially incorrect and incomplete financial statements that masked, concealed and omitted information concerning the Company's exposure to those assets and other credit-specific problems. ¶¶ 80-113, 160-173. *See O'Reilly v. Transworld Healthcare, Inc.*, 745 A.2d 902, 915 (Del. Ch. 1999) (a breach of the duty of loyalty will be found when allegations are "sufficient to support the inference that the disclosure violation was made in bad faith, knowingly or intentionally."). Directors' fiduciary duties are implicated whenever they "communicate publicly or directly with shareholders about the corporation's affairs[,] . . . and [when directors] are deliberately misinforming shareholders about the business of the corporation, either directly or by a public statement, there is a violation of fiduciary duty." *Malone v. Brincat*, 722 A.2d 5, at 10, 14 (Del. 1998) (*citing Zirn v. VLI Corp.*, 681 A.2d 1050, 1060-61 (Del. 1996)). *See In re InfoUSA, Inc. S'holders Litig.*, 2007 Del. Ch. LEXIS 123, at *59 (Aug. 13, 2007) (finding directors will be subject to liability in a derivative claim when "the directors involved issued their communication with the knowledge that it was deceptive or incomplete").

The members of the ARM Committee, constituting a majority of the Board, are each designated by the Company as a "financial expert" (¶ 183) and are charged with reviewing, discussing and ensuring the accuracy and truthfulness of Citigroup's financial statements and

public disclosures, disseminated deceptive and incomplete financial statements with the knowledge of such accounting standards.[42] ¶187. As financial experts, each of the ARM Committee members has experience in the preparation of financial statements and the application of such principles to, for example, estimating for reserves and accounting for and properly disclosing Citigroup's exposure to risk and certain off-balance sheet arrangements. ¶ 190. The financial experts on the ARM Committee have, or by virtue of their expertise should have, knowledge of standard accounting practices established by the FASB.[43] ¶¶ 160-173. Under FASB standards, Citigroup was required to fully explain and disclose its off-balance-sheet arrangements, such as CDOs and SIVs. ¶¶ 160-169. Armed with this knowledge, a majority of the Director Defendants, including the financial experts on the ARM Committee, failed to disclose the Company's full exposure to the subprime mortgage market and the risks associated therewith, in violation of standard accounting practices, including Citigroup's massive exposure to CDOs, SIVs and liquidity puts.[44] ¶¶ 70, 96, 165, 173.

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[42] The Court is entitled to infer, at the procedural stage of this case, that the knowledge of the ARM Committee members can be imputed to the entire Board. *See Saito v. McCall*, 2004 Del. Ch. LEXIS 205, at *14 n.71 (Dec. 20, 2004) (A "committee of the board, acting in good faith, would have openly communicated with each other concerning the accounting problems [uncovered] and would have shared the information with the board.").

[43] The FASB's reports are officially recognized as authorities by the SEC and American Institute of Certified Public Accountants. ¶ 160. The FASB issues statements of Financial Accounting Standards ("SFAS"), which sets forth actual standards, a summary of research, and a basis for the FASB's conclusions. FASB also issues Financial Interpretations ("FINs") that interpret certain SFASs. *Id.*

[44] As discussed more fully above, despite defendants' contentions to the contrary (Op. Br. at 33-34), plaintiffs do not suggest that the ARM Committee members should be held to a "higher standard" because of the financial qualifications they possessed, but rather that because of their expertise and experience with prior bad acts, these ARM Committee members knew, or should have known, the proper standards of financial reporting and accounting governing the preparation of financial reports. ¶¶ 160-173.

Defendants cite to cases in which the unsuccessful allegations were limited to seeking imposition of liability based only on the defendant's dissemination of false financial statements, and are thus inapposite. *See Wood v. Baum*, 953 A.2d 136 (Del. 2008) (plaintiffs only alleged defendants executed company's annual reports and other publicly-filed financial reports); *In re Coca-Cola Enters., Inc. Deriv. Litig.*, 478 F. Supp. 2d 1369, 1372-73 (N.D. Ga. 2007) (allegations the defendants caused company to disseminate false and misleading public statements); *Catholic Med. Mission Bd. v. Rittner*, No. 08-Civ. 0485 (N.D. Ala Nov. 4, 2008) (nothing to tie current board members to the alleged misstatements in press releases). By contrast, the Complaint specifically details that not only were the majority of the directors involved in the dissemination of Citigroup's financial statements and press releases, but that they also possessed the relevant knowledge regarding these disclosures. ¶¶ 81, 160-173, 186-193.

C. PLAINTIFFS' COMPLAINT ADEQUATELY ALLEGES DEMAND FUTILITY FOR CLAIMS INVOLVING WASTE

When considering a party's allegation that demand would be futile pursuant to Court of Chancery Rule 23.1, a Court will first assume all well-pled facts are true. *Grobow v. Perot*, 539 A.2d 180, 186 (Del. 1988). Next, the Court will determine whether the allegations raise a reasonable doubt as to: (i) director disinterest and independence; or (ii) whether the directors exercised proper business judgment in approving the challenged transaction. *Id.*; *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984). Count III of the Complaint challenges affirmative Board decisions to: (i) approve the Letter Agreement dated November 4, 2007 between Citigroup and defendant Prince (¶¶ 212-213); (ii) allow the Company to purchase over $2.7 billion in subprime loans from Accredited at one of its "fire sales" in March 2007 and from Ameriquest Home

Mortgage in September 2007 (¶ 214)[45]; (iii) approve the buyback of over $645 million worth of the Company's shares at artificially inflated prices pursuant to a repurchase program in early 2007 (¶ 215); and (iv) allow the Company to invest in SIVs that were unable to pay off maturing debt (¶ 216).[46]

When Board approval or action is involved – as contrasted with Board inaction as alleged in Counts I, II and IV – demand futility is analyzed under *Aronson*. Defendants correctly note that plaintiffs do not "contest the independence of a majority of the directors [for purposes of the Letter Agreement], and they do not allege that any of the directors had any personal interest in approving the agreement with Mr. Prince." Op. Br. at 39. Similarly, Plaintiffs do not allege that a majority of the relevant board members lacked independence with respect to the repurchase of Citigroup stock in 2007. Consequently, only the second prong of *Aronson* is implicated.

When analyzing claims under the second *Aronson* prong, "[t]he inquiry [ ] is whether a reasonable doubt is created that the Director Defendants' 'challenged transaction was otherwise the product of a valid exercise of business judgment.' In other words, demand will be excused if Plaintiffs' allegations raise a reasonable doubt that the Board was well-informed, careful and rational in approving" the challenged transaction. *In re Walt Disney Co. Derivative Litig*., 731 A.2d 342, 361 (Del. Ch. 1998) (citation omitted). "Under the business judgment rule, it is presumed that the board acted on an informed basis and that the directors honestly and in good

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[45] Defendants do not challenge plaintiffs' allegation that demand would be futile with respect to waste claims concerning the subprime loan sales because the claim is based on Board *inaction* rather than Board *action*. Consequently, plaintiffs have addressed demand futility of the waste claims concerning either of the subprime loan purchases here.

[46] Defendants do not contest plaintiffs' allegations that demand on the Board concerning the Company's investments in SIVs that were unable to pay off maturing debt would have been futile.

faith believed that the action was in the best interests of the corporation. Thus, in order 'to invoke the rule's protection directors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them.' In addition, the business judgment rule may not be invoked to shelter unauthorized actions of a board of directors." *Cal. Pub. Emples. Ret. Sys. v. Coulter*, 2002 Del. Ch. LEXIS 144, at *33-34 (Del. Ch. Dec. 18, 2002) (citations omitted).

"Under well-settled Delaware law, directors are [ ] liable for waste when they '"authorize an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration.'" *Disney*, 731 A.2d at 362 (citation omitted). The Director Defendants and defendants Prince, Jordan, Kleinfeld and Mecum are liable for waste because both the Letter Agreement and the stock buybacks were not the product of a valid exercise of business judgment and, instead, constituted waste.

1. The Complaint Raises A Reasonable Doubt As To The Board's Approval Of The Letter Agreement

Defendants' contention – that plaintiffs merely "parrot the 'so one-sided' standard, 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" (Op. Br. at 41) – is belied by the history of defendant Prince's resignation from the Company and the execution of the Letter Agreement detailed in the Complaint. The Complaint identifies the basis for the waste claim by setting forth the disturbing set of events supporting a reasonable doubt that the Director Defendants exercised any business judgment in awarding nearly $70 million to a former employee forced to resign from the Company after playing a pivotal role in exposing Citigroup to excessive risk and failing to take any steps to protect the Company from collapse. ¶¶ 122-124. *See* Cramer Aff. Ex. 1.

The Letter Agreement was executed contemporaneously with Defendant Prince's resignation from the Company, a departure categorized by defendant Prince himself as follows:

"[i]t is my judgment that the size of these charges makes stepping down the only honorable course for me." ¶ 119. The sizeable "charges" announced in connection with defendant Prince's resignation were the decline in fair value of approximately $55 billion worth of subprime exposures and a reduction in Company revenue of approximately $8 to $11 billion. ¶ 115. Furthermore, in connection with the announcement of these staggering financial losses, Citigroup shareholders also first learned of the Company's massive exposure to falling CDO values by virtue of its liquidity puts on the same date. ¶ 81, 118. In spite of Defendant Prince's inauspicious exit from the Company, the Letter Agreement awarded him all unvested outstanding employee stock options granted by the Company up to and including December 31, 2007, and remained exercisable for up to two years following December 31, 2007 provided Prince complied with certain covenants. ¶ 122. In all, defendant Prince was awarded a staggering $68 million, including his salary and accumulated stockholdings after resigning in shame.[47] ¶ 122. Adding insult to injury, defendant Prince was awarded an office, an administrative assistant, and a car and driver for the lesser of 5 years or until he commences full-time employment with another employer. ¶ 124. These particularized factual allegations, which the Court must accept as true, demonstrate the utter lack of any business judgment in agreeing to enter into the Letter Agreement. Further, most recently, *The New York Times* identified a string of disturbing inadequacies in Citigroup's risk management and control procedures that directly implicated defendant Prince, shedding additional light on his involvement in the Company's historic collapse. *See* Cramer Aff. Ex. 1. Up until September 2007, Defendant Prince turned a blind eye

[47] Defendants dispute that Price is receiving $68 million for his "retirement," (Op. Br. at 41 n.4), but do acknowledge all of the other perks Prince is receiving, including stock option awards, an administrative assistant, a car and driver and office. *Id.*

toward the Company's ownership of approximately $43 billion in mortgage-related assets. *Id.* In addition, Defendant Prince played a pivotal role in creating and repeatedly supporting risky strategies designed to take advantage of short-term profits at the expense of the Company's long-term viability and safety. *Id.* For example, Mr. Prince pressured certain employees to create additional CDOs to increase earnings. *Id.*

Allegations like the ones summarized above have repeatedly excused demand in connection with allegations of waste. *See Emerald Partners v. Berlin*, 1993 Del. Ch. LEXIS 273, *18-19 (Dec. 23, 1993) (plaintiff's allegation as to the waste of corporate assets was sufficient to create a reasonable doubt that the transaction was the result of a valid exercise of business judgment, because the director defendants knowingly approved a pledge of corporate assets in exchange for little to no consideration); *Calif. Public Employees' Ret. Sys. v. Coulter*, 2002 Del. Ch. LEXIS 144, *37-38 (Dec. 18, 2002) (demand was excused based on allegations of waste stemming from stock options that were repriced without any "analysis, evaluation, independent review, investment banking opinion, or advice from a compensation consultant or legal advisor.").

Defendants rely on inapposite caselaw and faulty logic in support of their argument. For example, in *Kernaghan v. Franklin*, 2008 WL 4450268, at *10 (S.D.N.Y. Sept. 29, 2008), the court noted that although plaintiff's complaint "appeare[d] to raise" a claim of corporate waste, the parties did not even brief the compensation package at issue in their motion papers submitted to the court. The *Kernaghan* court also noted that plaintiffs put forth no particularized allegations questioning the defendants' business judgment in approving the package. *Id.* The Complaint's fulsome allegations, as described above, stand in stark contrast. Furthermore, the consideration purportedly received by the Company in exchange for the Letter Agreement is illusory when

viewed against defendant Prince's resignation due to his role and inadequate service in connection with the Company's demise.

2. The Complaint Raises A Reasonable Doubt As To The Board's Approval Of The Stock Repurchase

The Complaint alleges that the Director Defendants and defendants Prince, Jordan, Kleinfeld and Mecum are also liable for waste for approving the buyback of over $645 million worth of the Company's shares at artificially inflated prices pursuant to a repurchase program. Under the circumstances, the repurchase program should have been suspended. ¶¶ 12(g), 110 - 112. Because these allegations concern a conscious decision to authorize the share buybacks, the second prong of *Aronson* is again the relevant test, and the Director Defendants thus had a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them.

In the middle of 2007, the Company announced that it had been actively managing down its exposure for some time. At the same time, the Company announced that its profits from consumer banking fell 15% in the second quarter of 2007, announced that it expected to see continued deterioration in consumer-credit quality through the year's second half, and that it would probably make "meaningful additions" to its loss reserves. ¶ 102-103. As a consequence of these disclosures, Company stock declined nearly 10% – from $51.13 to $46.97 – representing an 8.9% decline and wiping out approximately $20.8 billion in market share. ¶ 103. In response to the Company's declining stock price and expanding financial woes, during an October 15, 2007 conference call with analysts, defendant Crittenden announced that the Company would not buy back any additional shares until "we have reached our targeted capital ratios." ¶ 111. Citigroup had previously repurchased $12.8 billion of stock at an average price of $46.03 in 2005 and $7 billion in common stock in 2006 at an average price of $48.60 per share.

Nevertheless, in spite of its prior buybacks below $50 per share and in spite of the Company's expanding losses and declining stock price, Citigroup repurchased 12.1 million shares during the first quarter of 2007 at an average price of $53.37 – a total expenditure of $645 million. ¶ 112. At the time the Citigroup stock buybacks were halted, however, the Company's stock traded at only $46 per share. *Id.* Thus, the Director Defendants authorized and did not suspend the Company's share repurchase program, which resulted in the Company's buying back over $645 million worth of the Company's shares at artificially inflated prices. ¶¶ 112, 194.

As set forth in the Complaint, the Director Defendants recklessly failed to consider and account for the subprime lending crisis, the Company's exposure to falling CDO values by virtue of its liquidity puts, and the collective impact on the Company's billions in warehoused subprime loans. ¶¶ 81, 118. Consequently, the Director Defendants are not entitled to the presumption of business judgment and are liable for waste for approving the buyback of over $645 million worth of the Company's shares at artificially inflated prices pursuant to the repurchase program. Under the circumstances, the repurchase program should have been suspended, and would have saved the Company hundreds of millions of dollars. The magnitude of the Director Defendants' utter failure to properly inform themselves of the Company's dire straits has only been highlighted by the Company's recent historically low share prices.

These allegations, in short, illustrate the Director Defendants' utter failure to inform themselves of all relevant information concerning the subprime crisis and, consequently, their actions are not subject to the protections normally afforded by the business judgment rule. Based on the facts alleged in the Complaint, the stock buyback constituted a give away and irrational squandering of corporate assets. *Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000).

D. PLAINTIFFS' CLAIMS FOR BREACH OF FIDUCIARY DUTY ARE NOT BARRED BY Del. C. § 102(b)(7)

Defendants' efforts to shield their misconduct behind Section 102(b)(7) ignores well-settled Delaware law. To prevail on a motion to dismiss based on a charter's exculpatory clause, defendants must show that the complaint *unambiguously* states a claim *only* for a breach of the duty of care. *See, e.g., Orman*, 794 A.2d at 41 (denying motion to dismiss based on exculpatory clause where allegations made it reasonable to question the independence and disinterest of a majority of the board); *In re Ply Gem*, 2001 Del. Ch. LEXIS 84 at *40; *Sanders v. Wang*, 1999 Del. Ch. LEXIS 203 at *35 (Del. Ch. Nov. 8, 1999) (denying motion to dismiss based on exculpatory clause because nature of breach of duty unclear, explaining "[a]t this stage of the proceedings, I cannot conclude as a matter of law that the Board acted in good faith and their actions constituted no more than mere carelessness").

In addition to duty of care allegations, the Complaint alleges conduct by defendants that falls squarely within the Court's definition of directorial failure to act in good faith, constituting a breach of the non-exculpable, non-indemnifiable duty of loyalty. *See Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006) (citations omitted). As this Court has stated, "[o]ne of the most important duties of a corporate director is to monitor the potential that others within the organization will violate their duties." *ATR-Kim ENG Financial Corp v. Araneta*, 2006 Del. Ch. LEXIS 215, at *71-*72 (Dec. 21, 2006). This includes "a duty to attempt in good faith to assure that a corporate information and reporting system, which the board considers to be adequate, exists." *Id.* at *72. While purportedly supervisory mechanisms might have been in place at Citigroup, defendants have not made a good faith attempt to assure that adequate and proper corporate information and reporting systems existed that would enable them to be fully informed regarding Citigroup's risk to the subprime mortgage market. Because the Complaint does not exclusively allege a breach of the duty of care (¶ 80, 188, 192, 202), the charter's Section 102(b)(7) provision "cannot operate

to negate plaintiffs' duty of care claim on a motion to dismiss." *Alidina v. Internet.com Corp.*, 2002 Del. Ch. LEXIS 156, *28 (Del. Ch. 2002). *See also Emerald Partners v. Berlin*, 787 A.2d 85, 91 (Del. 2001); *Malpiede*, 780 A.2d at 1095.

Moreover, a Section 102(b)(7) charter provision does not eliminate a director's fiduciary duty of care. R. Franklin Balotti & Jesse A. Finkelstein, 1 *The Delaware Law of Corporations and Business Organizations* § 4.13[B], at 4-93 (3d ed. 2008). The duty of care is still applicable "to the extent plaintiffs seek equitable relief for any alleged breaches of the duty of care." *Leslie v. Telephonics Office Techs., Inc.*, 1993 Del. Ch. LEXIS 272, *30 (Del. Ch. 1993); *see also Chaffin*, 1999 Del. Ch. LEXIS 182 at *21. On a motion to dismiss, the Court should only address whether a claim upon which relief may be grant has been stated, and not the feasibility of equitable relief. *Id*. at *22. Indeed, the remedies sought by the Complaint are not strictly monetary. Plaintiffs seek equitable remedies such as: (i) requiring that the Letter Agreement be abrogated and voided; and (ii) ordering the Individual Defendants to implement and enforce policies, practices and procedures that will detect and prevent illegal conduct by Citigroup's employees and representatives. ¶ 226(f), (g).

E. PLAINTIFFS' COMPLAINT STATES A CLAIM PURSUANT TO RULE 12(B)(6)

The standard applicable to a motion to dismiss pursuant to Chancery Court Rule 12(b)(6) is well-settled: "(i) all well-pleaded factual allegations are accepted as true; (ii) even vague allegations are 'well-pleaded' if they give the opposing party notice of the claim; (iii) the Court must draw all reasonable inferences in favor of the non-moving party; and (iv) dismissal is inappropriate unless the 'plaintiff would not be entitled to recover under any reasonably conceivable set of circumstances susceptible of proof.'" *In re GM (Hughes) S'holder Litig*., 897 A.2d 162, 168 (Del. 2006) (*citing Savor, Inc. v. FMR Corp*., 812 A.2d 894, 896-97 (Del. 2002)). The Court should not grant a motion to dismiss unless "it appears with 'reasonable certainty' that

the plaintiff could not prevail on any set of facts that can be inferred from the pleading." *Id.* (*See also Allied Capital Corp. v. GC-Sun Holdings, L.P.*, 910 A.2d 1020, 1030 (Del. Ch. 2006); *Feldman v. Cutaia*, 956 A.2d 644, 654 (Del. Ch. 2007)).

"[W]here [the] plaintiff alleges particularized facts sufficient to prove demand futility under the second prong of *Aronson,* that plaintiff *a fortiori* rebuts the business judgment rule for the purpose of surviving a motion to dismiss pursuant to Rule 12(b)(6)." *Ryan*, 918 A. 2d at 357. In other words, "[b]ecause the standard under Rule 12(b)(6) is less stringent than that under Rule 23.1, a complaint that survives a motion to dismiss pursuant to Rule 23.1 will also survive a 12(b)(6) motion to dismiss, assuming that it otherwise contains sufficient facts to state a cognizable claim." *McPadden v. Sidhu*, 2008 Del. Ch. LEXIS 123, *20 (Del. Ch. Aug. 29, 2008).[48] As more fully described above, *see supra* Section IV.B., the Complaint adequately alleges demand futility with respect to each of the derivative claims alleged. Consequently, the Court should deny defendants' motion to dismiss the Complaint pursuant to Rule 12(b)(6) on those grounds alone.

In the alternative, the Complaint independently satisfies Rule 12(b)(6) and adequately states claims for breaches of the duties of oversight and disclosure, waste, and reckless and gross mismanagement.

1. The Complaint States a Claim for Breach of the Duty of Oversight

As set forth more fully above, the Complaint adequately states a claim for breach of fiduciary duty based on a failure of oversight under *Caremark*. "Caremark articulates the

[48] "[T]he issue of whether demand is futile so as to be excused is logically antecedent to whether plaintiff states a claim because, if demand is not made or is not otherwise excused, the complaint will be dismissed without any further inquiry into the merits of the complaint." *McPadden*, 2008 Del. Ch. LEXIS 123 at *20-21 (*citing Aronson*, 473 A.2d at 811.)

necessary conditions predicate for director oversight liability: (a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or 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. In short, in order to properly plead a *Caremark* claim of a breach of the duty of oversight, a plaintiff must show "that the directors knew that they were not discharging their fiduciary obligations." *Id*. The Complaint amply satisfies these requirements.

Indeed, Courts will not hesitate to excuse demand and deny a motion to dismiss pursuant to Rule 12(b)(6) when a complaint illustrates such callous disregard for directorial duties. *See Saito v. McCall*, 2004 Del. Ch. LEXIS 205, at *31 n.66. (Dec. 20, 2004) (denying defendants' motion to dismiss plaintiffs' claim under both Rule 23.1 and Rule 12(b)(6) that defendants failed to, *inter alia*, implement sufficient internal controls, and noting that "[a]lthough a *Caremark* claim is difficult to advance, on a motion to dismiss I must find that the plaintiff would not be entitled to relief under ***any set of facts that could be proven*** to support the claim.") (emphasis in original) (internal citations omitted).

2. The Complaint States a Claim for Breach of the Duty of Disclosure

"Delaware law [ ] protects shareholders who receive false communications from directors even in the absence of a request for shareholder action. When the directors are not seeking shareholder action, but are deliberately misinforming shareholders about the business of the corporation, either directly or by a public statement, there is a violation of a fiduciary duty, [which] may result in a derivative claim on behalf of the corporation." *Malone*, 722 A.2d at 14. The Complaint sets forth allegations that the Directors Defendants caused Citigroup to improperly value numerous subprime mortgage related securities and off-balance sheet entities in violation of FASB accounting standards and the resulting instances where Citigroup omitted

material facts concerning its risky financial exposures, including financial information regarding Citigroup's exposure to those assets and information necessary to prevent the statements contained therein from being misleading. ¶¶ 80-119.

3. The Complaint States a Claim for Corporate Waste

The test for corporate waste requires that the plaintiff plead "facts showing that no person of ordinary sound business judgment could view the benefits received in the transaction as a fair exchange for the consideration paid by the corporation." *In re Lear Corp. S'holder Litig*., 2008 Del. Ch. LEXIS 121, *48 (Sept. 2, 2008) (citation omitted). Waste has also been characterized as "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." *Lewis v. Vogelstein*, 699 A.2d 327, 336 (Del. Ch. 1997).

This Court has not hesitated to deny motions to dismiss waste claims where particularized facts such as those alleged here, demonstrate a reasonable doubt as to transactions "substantially below" market. *Stein v. Orloff*, 1985 Del. Ch. LEXIS 418, *12-13 (May 30, 1985) (denying motion to dismiss waste claims premised on pre-existing options on which the option price was reduced without any consideration); *Andreae v. Andreae*, 1992 Del. Ch. LEXIS 44, *16-17 (Mar. 3, 1992) (denying motion to dismiss claim that Board's decision to sell corporate assets at 50% of the original premium constituted waste); *Avacus Partners, L.P. v. Brian*, 1990 Del. Ch. LEXIS 178, *26-32 (Oct. 24, 1990) (denying motion to dismiss and finding "a litigable case of waste" where facts alleged company paid over ten times fair market value for a large block of stock and also paid 100 times the price paid a year earlier for control of a second company); *Weiss v. Swanson*, 948 A.2d 433, 450 (Del. Ch. 2008) (*citing Zupnick v. Goizueta*, 698 A.2d 384, 387 (Del. Ch. 1997)) ("regarding allegations that grants were approved without any valid corporate purpose, the court [could not] conclude that there is no reasonably conceivable set

of facts under which Weiss could prove a claim of waste. Therefore, Weiss has pleaded a claim for waste.").

Here, and as more fully set forth above, *see supra* Section IV.C., the Complaint satisfies the relevant standard for waste. The Complaint explains that the Letter Agreement lacked any value for the Company and was executed in conjunction with defendant Prince's utter failure to take any steps to properly fulfill his duties. ¶¶ 122-124. The Complaint also alleges that Citigroup's investment in SIVs constituted waste because many investors were no longer willing to purchase commercial paper from its SIVs, leaving the SIVs unable to raise money by selling new commercial paper and forcing the SIVs to sell their assets at fire-sale prices to pay off debts. ¶¶ 95, 126, 130, 132, 135, 136. Consequently, Citigroup's SIVs were on the verge of collapse, subjecting the Company to billions of dollars in liability as a result of investor lawsuits for causing the conduits to issue debt based on materially false and misleading statements. ¶ 95. The Complaint also illustrates that Citigroup received no value for either its inflated stock buybacks or purchases of overvalued loans. ¶ 77, 111, 178, 191.

4. The Complaint States a Claim for Reckless and Gross Mismanagement

Defendants concede that if plaintiffs have adequately pled a *Caremark* claim, then they necessarily have pled claims for reckless and gross mismanagement as well. *See* Op. Br. at 47-48. Thus, because, as discussed above, Plaintiffs have stated claims for breach of fiduciary duty under Caremark, they have pled claims for reckless and gross mismanagement.

V. CONCLUSION

For all of the foregoing reasons, plaintiffs respectfully request that the Court deny defendants' Motion to Dismiss or Stay.

Dated: January 7, 2009

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