Siegal v J.P. Morgan Chase & Co.
2012 NY Slip Op 33174(U)
August 16, 2012
Supreme Court, New York County
Docket Number: 651974/11
Judge: Charles E. Ramos
Republished from New York State Unified Court System's E-Courts Service. Search E-Courts (http://www.nycourts.gov/ecourts) for any additional information on this case.
This opinion is uncorrected and not selected for official publication.

[* 1]
FILED: NEW YORK COUNTY CLERK 08/24/2012
NYSCEF DOC. NO. 23

INDEX NO. 651974/2011
RECEIVED NYSCEF: 08/24/2012

SUPREME COURT OF THE STATE OF NEW YORK - NEW YORK COUNTY

PRESENT: Ramos
Justice

PART 53

MARTIN J. SIEGAL

- V -

J.P. MORGAN CHASE & CO, et al

INDEX NO. 651974/2011

MOTION DATE

MOTION SEQ. NO. 002

MOTION CAL. NO.

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

Notice of Motion/Order to Show Cause - Affidavits - Exhibits ____ No(s) ____

Answering Affidavits - Exhibits ____ No(s) ____

Replying Affidavits ____ No(s) ____

Upon the foregoing papers, it is ordered that this motion is

is decided in accordance with accompanying memorandum decision and order.

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

DATED: 8/23/2012

____ **J.S.C.**

1. CHECK ONE : [x] CASE DISPOSED [ ] NON-FINAL DISPOSITION

2. CHECK AS APPROPRIATE : MOTION IS: [x] GRANTED [ ] DENIED [ ] GRANTED IN PART [ ] OTHER

3. CHECK IF APPROPRIATE : [ ] SETTLE ORDER [ ] SUBMIT ORDER

[ ] DO NOT POST [ ] FIDUCIARY APPOINTMENT [ ] REFERENCE

[* 2]

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION
---x
MARTIN J. SIEGAL,

Index No. 651974/11

Plaintiffs,

- against -

J.P MORGAN CHASE & CO, J.P. MORGAN SECURITIES, LLC, J.P MORGAN ACCEPTANCE CORPORATION, CRANDALL C. BOWLES, STEPHEN B. BURKE, DAVID M. COTE, JAMES S. CROWN, JAMES DIMON, ELLEN V. FUTTER, WILLIAM H. GRAY, III, LABAN P. JACKSON, JR., DAVID C. NOVAK, LEE R. RAYMOND, WILLIAM C. WELDON, CARLOS M. HERNANDEZ, SAMUEL TODD MACLIN, JEFFREY CARL BERNSTEIN, CHRISTINE E. COLE, EDWIN F. MCMICHAEL, WILLIAM A. KING, MICHAEL MINIKES, JAMES EDWARD STALEY, FELICE DIIORIO, JEFFREY HERBERT URWIN, GREGORY GIL QUENTAL, PAUL WHITE, BRIAN BEHARD, DAVID M. DUZYK, MATTHEW CHERWIN, and VICTOR A. DUVA.

Defendants.
---x

Charles Edward Ramos, J.S.C.:

Defendants J.P. Morgan Chase & Co. (JP Morgan), J.P. Morgan Securities, LLC (JPM LLC), J.P. Morgan Acceptance Corporation (JPM Acceptance), and JP Morgan's board of directors[1] (together, JP Morgan defendants) move to dismiss the complaint pursuant to CPLR 3211 (a)(7), and Delaware Chancery Court Rule 23.1.

---

[1] The individual defendants are Crandall C. Bowles, Stephen B. Burke, David M. Cote, James S. Crown, James Dimon, Ellen V. Futter, William H. Gray, III, Laban P. Jackson, JR., David C Novak, Lee R. Raymond, William C. Weldon, Carlos M. Hernandez, Samuel Todd Maclin, Jeffery Carl Bernstein, Christine E. Cole, Edwin F. McMichael, William A King Michael Minikes, James Edward Staley, Felice Diiorio, Jeffrey Herbert Urwin, Gregory Gil Quental, Paul White, Brian Behard, David M. Duzyk, Matthew Cherwin, and Victor A. Duva.

[* 3]

Background[2]

Plaintiff Martin J. Siegal (Plaintiff) is a shareholder of JP Morgan. After the SEC fined JP Morgan $153.6 million for misleading investors of Residential Mortgage-Backed Securities (RMBS), Plaintiff commenced this derivative action against the board of directors of JP Morgan and its subsidiaries, JPM Acceptance and JPM LLC, seeking damages. Plaintiff also seeks to hold the JP Morgan defendants liable for authorizing JP Morgan's acquisition of Bear Stearns and Washington Mutual, and for assuming all of their RMBS liabilities, thereby exposing JP Morgan to more risk.

JP Morgan is incorporated in Delaware and is authorized to conduct business in the State of New York, with its principal place of business in New York City. JP Morgan is a bank-holding company, that owns and controls a number of corporations engaged in banking and securities transactions. Through its wholly-owned subsidiaries,[3] JPM Acceptance and JPM LLC, JP Morgan is heavily involved in the origination, securitization, and sale of securitized mortgages to public investors.

---

[2] The facts set forth below are taken from plaintiff's Second Amended Complaint (SAC).

[3] Plaintiff alleges that JP Morgan only owned 75% of JPM LLC. For purposes of this action, however, the difference is immaterial (see Plaintiff's Memo in Opp., 10) ("JPM LLC being owned 75% by Morgan Chase is deemed to be a Morgan Chase entity").

JPM Acceptance serves as depositor for JP Morgan's mortgage securitizations, and in this capacity, is charged with creating residential mortgage backed securities (RMBS) from JP Morgan's pools of mortgages. To this end, JPM Acceptance filed registration statements with the SEC containing a description of JP Morgan's mortgage pools and an explanation of the general structure of the investment. Once securitized, the RMBS are placed in a trust, and corresponding certificates are issued. For each successful securitization, JPM Acceptance earns a percentage of the offering's total dollar value.

JPM LLC is JP Morgan's lead underwriter, and sells the certificates issued by the trust to public investors. For every RMBS sale, JPM LLC earns a commission calculated from the total amount of money the sale generated.

Plaintiff asserts four claims against the individual members of JP Morgan's board of directors in addition to JP Morgan and its subsidiaries, JP Acceptance and JP LLC, alleging that they breached their duties by authorizing and pushing sales of RMBS, while fully aware that its own internal staff, and third-party mortgage application evaluators, had weakened its application review standards, and that certain economists believed that RMBS financing was based on faulty economic assumptions. According to Plaintiff, JP Morgan failed to conduct adequate due diligence on the RMBS and failed to insure the accuracy of registration statements it filed in connection with its investments, and

[* 5]

signed and filed registration statements knowing that some or all of the representations made were false.

In addition, Plaintiff alleges that the JP Morgan defendants breached their duties by approving the acquisition of Bear Stearns and Washington Mutual, which exposed JP Morgan to unnecessary risk because under the terms of the acquisition, JP Morgan assumed all of Bear Stearns and Washington Mutual's RMBS-related liabilities, thereby further exposed JP Morgan to RMBS-related losses.

Plaintiff did not make a demand on JP Morgan's board prior to commencing this derivative action.

Discussion

Defendants move to dismiss the complaint for failure to make a demand, as required under Delaware law. Plaintiff argues that a demand is unnecessary because this action is governed by New York Banking Law. Alternatively, Plaintiff argues that demand should be excused as futile.

I. Applicable Law

As a threshold matter, the Court determines that Delaware law governs Plaintiff's claims. Under the internal affairs doctrine, corporations are governed by the law of the state in which they are incorporated (*Hart v General Motors Corp,* 129 AD2d 179, 183-84 [1st Dept], *app denied* 70 NY2d 608 [1987]).

[* 6]

JP Morgan is incorporated in the state of Delaware. Accordingly, Delaware law governs the claims which appear to be for waste and mismanagement.

II. The Demand Requirement under Delaware Law

Under Delaware Chancery Court Rule 23.1, in a derivative action brought by one or more shareholders, the complaint must allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors, and the reasons for the plaintiff's failure to obtain the action or for not making the effort.

The requirement of pre-suit demand recognizes the business and affairs of the corporation (*Kaplan v Peat, Marwick, Mitchell & Co.*, 540 A2d 726, 731 [Del 1988]), and assures that the shareholder affords the corporation the opportunity to address an alleged wrong without litigation (*Aronson v Lewis*, 473 A2d 805, 807, 814, 819 [Del 1984]) (overruled on other grounds by *Brehm v Eisner*, 746 A2d 244, 253 [Del 2000]). Stockholders' rights to prosecute a derivative suit on their own are thus limited to situations where the stockholder: (I) has demanded that the directors pursue the corporate claim and they have wrongfully refused to do so, or (ii) where demand is excused because the directors are incapable of making an impartial decision regarding such litigation (*Rales v Blasband*, 34 A2d 927, 932 [Del 1993]).

III. Demand Futility

Failure to make a demand is excused when the demand would be futile (*Aronson*, 473 A2d at 807). Under Delaware Chancery Court Rule 23.1(a), shareholders must allege with factual particularity their reasons for not making a demand on the board. The pleading burden for demand futility is "more onerous" than the burden a plaintiff must satisfy when confronted with a motion to dismiss (*Levine v Smith,* 591 A2d 194 [Del 1991]). Conclusory allegations are not considered as expressly pleaded facts or factual inferences (*Brehm v Eisner,* 746 A2d 244 [Del 2000]).

The trial court, using its discretion, must determine whether the complaint alleges particularized facts which create a reasonable doubt that (1) the directors are disinterested and independent; and (2) the challenged transaction was otherwise the valid exercise of business judgment (*Aronson,* 473 A2d at 814). By contrast, where the complaint challenges a board's failure to act, demand is futile if the court determines that the particularized factual allegations of the complaint create a reasonable doubt that the board is independent or disinterested in responding to the demand (*Rales v Blasband*, 634 A2d 927, 934 [Del 1993]).

Plaintiff appears to be challenging both affirmative decisions of JP Morgan's board and failure to act. Directors' disinterestedness and independence are elements of both tests, and thus, are material to the analysis of demand futility.

A. Disinterestedness and Independence

[* 8]

Plaintiff's allegations are insufficient to raise a reasonable doubt as to the disinterestedness or independence of the board members. "Directorial interest exists whenever divided loyalties are present, or a director either has received, or is entitled to receive, a personal financial benefit from the challenged transaction which is not shared equally by the stockholders" (*Pogostin v Rice*, 480 A2d 619, 624 [Del 1984]).

To assert director dependence, plaintiffs must allege particularized facts creating a reasonable doubt that a director is not so "beholden" to an interested director that his or her "discretion would be sterilized" (*Beam ex. rel. Martha Stewart Living Omnimedia, Inc. v Stewart*, 845 A2d 1040, 1050 [Del 2004]) (quoting *Aronson*, at 816). A disinterested director "can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from [the challenged transaction] in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally" (*Aronson, 473 A2d* at 812).

Ultimately, a showing of a substantial likelihood of director liability for an alleged wrong will only call a director's independence or disinterestedness into question in a rare case where the transaction was so egregious on its face that board approval cannot meet the test of business judgment (*Aronson*, 473 A2d at 815).

Plaintiff alleges that JP Morgan mislead investors by promoting the sale of RMBS knowing that its internal staff had weakened its standards of evaluating mortgages, while representing that the RMBS offerings were triple-A rated, and signed and filed registration statements knowing that *some* or all of the representations made in those statements might be false" (SAC at 22).

Additionally, Plaintiff alleges that unnamed board members had a financial incentive to complete many RMBS offerings as quickly as possible, without regard to ensuring the accuracy or completeness of the registration statements they filed with the SEC. Plaintiff also challenges the decision to authorize the acquisition of Washington Mutual and Bear Stearns, to the extent that JP Morgan assumed their RMBS obligations.

Plaintiff offers only conclusory allegations that the individual board members pushed the program of promoting RMBS offerings, and authorized the acquisitions of Bear Stearns and Washington Mutual "with knowledge of the foregoing." Plaintiff does not allege specific facts tying any of JP Morgan's directors to specific acts of wrongdoing, and merely states that three unspecified members of the board signed registration statements. He does not identify when the wrongdoing occurred, or in some instances, references conduct that occurred as early as 2006, which is more than three years before the complaint was filed. Otherwise, Plaintiff has not alleged any facts that Defendants

received any personal benefit from their RMBS dealings or from their approval of the acquisition of JP Morgan's Washington Mutual and Bear Stearns, sufficient to raise doubts that they were interested.

As to the element of independence, Plaintiff presumes that any director is beholden to his or her superior. However, eleven of the twelve members of the JP Morgan board are outside directors. In the absence of particularized facts establishing that the business relationship to their superior is "material," Plaintiff fails to raise a reasonable doubt concerning these directors' independence.

Therefore, the Court concludes that the conclusory allegations lack factual particularity and are insufficient to make the strong showing necessary to create a substantial likelihood of director liability either as to the elements of independence or disinterestedness.

B. Business Judgment

Plaintiff also fails to cast a reasonable doubt that the transactions, viewed substantively, were not the result of a valid exercise of business judgment (*Aronson,* 473 A2d at 812-14). To allege an invalid exercise of business judgment, a plaintiff must rebut the presumption that "the directors of a corporation acted on an informed basis [in making a business decision], in good faith and in the honest belief that the action taken was in the best interest of the company" (*Id.*). To rebut the

presumption, plaintiffs must "plead particularized facts sufficient to raise (1) a reason to doubt that the action was taken honestly and in good faith or (2) a reason to doubt that the board was adequately informed in making the decision" (*In re Walt Disney Co*, 825 A2d 275, 286 [Del Ch Ct 2003]). "If, under the facts pled in the complaint, any reasonable person might conclude that the deal made sense, then the judicial inquiry ends" (*Harbor Finance Partners v Huizenga*, 751 A2d 879, 892-93 [Del Ch 1999]).

As to all of his claims, Plaintiff does not plead particularized facts showing that JP Morgan defendants were uninformed or acted in bad faith, or that no reasonable person of ordinary business judgment could believe that the transactions at issue were advisable for JP Morgan.

Finally, Plaintiff's assertion that demand is excused because directors cannot be expected to sue themselves does not pass muster, and is an argument that is routinely rejected (*see Aronson*, 473 A2d at 818). For these reasons, Plaintiff has failed to demonstrate that demand is excused, and thus, the action must be dismissed.

Accordingly, it is

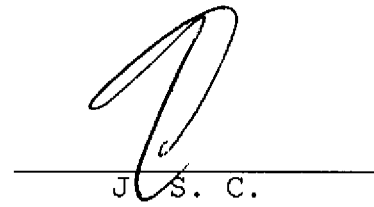
ORDERED that the motion to dismiss the complaint is granted, and the complaint is dismissed in its entirety; and it is further

ORDERED that the Clerk is directed to enter judgment

accordingly.

Dated: August 16, 2012

ENTER:



J. S. C.