| **Retirement Plan for Gen. Empls. of the City of N. Miami Beach v McGraw** |
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| 2016 NY Slip Op 32654(U) |
| December 21, 2016 |
| Supreme Court, New York County |
| Docket Number: 652695/2015 |
| Judge: Jeffrey K. Oing |
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# SUPREME COURT OF THE STATE OF NEW YORK
# NEW YORK COUNTY

PRESENT: JEFFREY K. OING J.S.C. *Justice* PART 48

Index Number : 652695/2015
RETIREMENT PLAN FOR GENERAL
vs.
MCGRAW III ,HAROLD
SEQUENCE NUMBER : 002
DISMISS

INDEX NO. ______
MOTION DATE ______
MOTION SEQ. 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

Mtn decided in accordance w/ accompanying memorandum decision/order of this court.

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

Dated: 12/21/16 ______, J.S.C.
JEFFREY K. OING
J.S.C.

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

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL PART 48
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RETIREMENT PLAN FOR GENERAL EMPLOYEES OF THE CITY OF NORTH MIAMI BEACH and ROBIN STEIN, on behalf of themselves and derivatively on behalf of MCGRAW HILL FINANCIAL, INC.,

Plaintiffs,

-against-

HAROLD MCGRAW III, CHARLES E. HALDEMAN, JR., PEDRO ASPE, ROBERT P. MCGRAW, HILDA OCHOA-BRILLEMBOURG, EDWARD B. RUST JR., SIR WINFRIED BISCHOFF, WILLIAM D. GREEN, DOUGLAS N. DAFT, LINDA KOCH LORIMER, JAMES H. ROSS, KURT L. SCHMOKE, SIDNEY TAUREL, SIR MICHAEL RAKE, REBECCA JACOBY, DOUGLAS L. PETERSON, RICHARD E. THORNBURGH, DEVEN SHARMA, KATHLEEN CORBET, and VICKI TILLMAN,

Defendants

-and-

MCGRAW-HILL FINANCIAL, INC.,

Nominal Defendants.

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**Index No.: 652695/2015**

**Mtn Seq. Nos. 002 & 003**

**DECISION AND ORDER**

**JEFFREY K. OING, J.:**

**Relief Sought**

**Mtn Seq. No. 002**

Nominal defendant McGraw-Hill Financial, Inc. ("McGraw-Hill") moves, pursuant to CPLR 3211(a)(3) and Business

Corporation Law ("BCL") § 626(c) to dismiss plaintiffs' Verified Shareholder Derivative Complaint.

**Mtn Seq. No. 003**

Defendants Pedro Aspe, Winfried Bischoff, Douglas N. Daft, William D. Green, Charles E. Haldeman, Jr., Rebecca Jacoby, Linda Koch Lorimer, Harold McGraw III, Robert P. McGraw, Hilda Ochoa-Brillembourg, Douglas L. Peterson, Michael Rake, James H. Ross, Edward B. Rust, Jr., Kurt L. Schmoke, Sidney Taurel, and Richard E. Thorn move, pursuant to CPLR 3013, 3016(b), 3211(a)(1), 3211(a)(5) and 3211(a)(7), to dismiss the complaint.

Both motions are consolidated for disposition.

**Factual Background**

McGraw-Hill provides ratings, analytics, data, and research to the global capital, commodities, and commercial markets (Compl., ¶ 24). It has four operating segments: Standard & Poor's Ratings ("S&P"), S&P Capital IQ, S&P Dow Jones Indices, and Commodities & Commercial (Compl., ¶ 24). S&P is a credit rating agency which issues assessments of credit risks to investors (Compl., ¶ 52).

The gravamen of plaintiffs' complaint is that, between 2004 and 2007, S&P employees wrongfully rated residential mortgage-backed securities ("RMBS"), commercial mortgage-backed securities

("CMBS"), and collateralized debt obligations ("CDO") as sound investments, and that defendants were aware of this misconduct -- or should have been aware of it -- and did nothing to stop it (Compl., ¶¶ 250-254). Plaintiffs also allege that similar ratings misconduct occurred between 2010 and 2014 (Compl., ¶¶ 214, 228-234).

On August 29, 2007, the New York State Attorney General requested information and documents relating to S&P's RMBS ratings (Compl., ¶ 216). On August 31, 2007, the United States Securities and Exchange Commission ("SEC") initiated an examination into the three major credit rating agencies, including S&P (Compl., ¶ 217). In the fall of 2007, 19 state attorneys general as well as the District of Columbia began investigations into the accuracy of S&P's ratings, as did the United States Department of Justice ("DOJ") (Compl., ¶ 272). In July 2008, the SEC issued a report discussing the failings of these ratings agencies in their ratings of RMBS and CDOs (Compl., ¶ 218).

On February 4, 2013, the DOJ filed a civil fraud complaint against McGraw-Hill related to these improper ratings (the "DOJ Action") (Compl., ¶ 9). In and around this time, 19 states and the District of Columbia also filed lawsuits against McGraw-Hill

and S&P related to the improper rating of mortgage-related securities they had purchased (the "State Actions") (Compl., ¶ 9). On February 3, 2015, McGraw-Hill resolved these various lawsuits for approximately $1.375 billion (Compl., ¶ 14).

Subsequently, plaintiffs commenced this action on August 3, 2015, asserting derivative claims against McGraw-Hill as well as: (1) McGraw-Hill's current Board of Directors, Haldeman Jr., Bischoff, Green, Jacoby, Robert P. McGraw, Ochoa-Brillembour, Peterson, Rake, Rust Jr., Schmoke, Taurel, and Thornburgh (the "Current Directors"); (2) former McGraw-Hill directors Harold McGraw III, Aspe, Daft, Lorimer, and Ross (the "Former Directors" and, with the Current Directors, the "Director Defendants"); and (3) current and former McGraw-Hill executive officers Sharma, Corbet, and Tillman (the "Officer Defendants" and, with the Director Defendants, the "Individual Defendants").

Plaintiffs assert claims against all of the defendants for breach of fiduciary duty based on defendants' purported: (1) failure to prevent McGraw-Hill and S&P from violating federal and state laws; and (2) waste of corporate assets due to the settlement of the actions resulting from these violations (Compl., ¶¶ 305, 314). Plaintiffs also interpose a claim against the Director Defendants for breaching their fiduciary duties of

due care, diligence and candor by: (1) knowingly or recklessly disregarding the unreasonable risks and losses associated with S&P's internal misconduct, and (2) willfully failing to monitor the problems with McGraw-Hill's internal controls relating to S&P's RMBS and CDO ratings (Compl., ¶¶ 318-328).

**Discussion**

Dismissal of the complaint is mandated on multiple grounds. First, plaintiffs failed to make a demand on the Board of Directors (the "Board"), and have not sufficiently pleaded demand futility. Second, plaintiffs' claims are time-barred. Third, plaintiffs have not sufficiently pleaded a breach of fiduciary duty on the part of defendants. And, fourth, plaintiffs' claims as to the Director Defendants are barred by McGraw-Hill's Certificate of Incorporation.

**I. Demand Futility**

BCL § 626(c) requires that a shareholder seeking to maintain a derivative action "set forth with particularity the efforts of the plaintiff to secure the initiation of such action by the board or the reasons for not making such effort" (BCL § 626[c]). Given that plaintiffs did not make a demand on the Board, they must allege with particularity that such a demand would have been futile. A demand is futile when: (1) a majority of the board of

directors are interested in the transaction; (2) the board of directors failed to inform themselves about the challenged transaction to the extent reasonably appropriate under the circumstances; or (3) the challenged transaction was so egregious on its face that it could not have been the product of sound business judgment by the board of directors (Goldstein v Bass, 138 Ad3d 556 [1st Dept 2016], citing Marx v Akers, 88 NY2d 189, 198 [1996]).

Plaintiffs first argue that demand was futile because the Director Defendants knew or should have known about S&P's fraudulent ratings practices. Absent further elucidation, this position is insufficiently particularized to satisfy BCL § 626(c) (City of Tallahassee Retirement System v Akerson, 2009 WL 6019489 [Sup Ct, NY Sup 2009]). They also argue that the Director Defendants are interested because they ignored certain "red flags" indicating S&P's misconduct, namely: (1) the inherent conflict in S&P's business model; (2) S&P's delays in updating the analytical model used to rate RMBS prior to 2008; (3) federal and state investigations into S&P and industry credit-rating practices commenced in 2007; and (4) news coverage of the deteriorating subprime mortgage market.

These "red flags" do not demonstrate that the directors had specific information or reason to inform themselves about the details of S&P's ratings misconduct, yet failed to do so. First, although plaintiffs claim that S&P's financial performance, combined with the inherent conflict in S&P's "issuer-pays" business model (i.e., as issuers of securities paid to have S&P rate the issuers' proposed product S&P was pressured to give the rating the issuer wanted or lose the issuers' business to a more pliable competitor) should have been a red flag to the Board, the complaint acknowledges that S&P publicly stated that it adopted "robust" controls to ensure that potential conflicts would not affect its ratings (Compl. ¶¶ 100-108). The complaint fails to allege that the Board was given any reason to doubt these representations. Similarly, although plaintiffs posit that the Board should have seen delays in updates to S&P's analytical models as a red flag, the complaint fails to allege that the Board was informed of the rationale for -- or the length of -- this delay.

While plaintiffs argue that the Congressional hearings into the ratings process and investigations by state and federal authorities which began in 2007 should have been a red flag to the Board, the complaint alleges that, after these investigations

commenced, S&P made efforts to tighten its ratings criteria and improve transparency (Compl. ¶¶ 196-200). Plaintiffs fail to allege that the Board had reason to believe that these efforts were ineffective. Accordingly, plaintiffs' assertion that the Board was remiss in failing to take action is not supported by this record.

Finally, plaintiffs' reliance on news coverage of the deteriorating subprime market is unavailing, as generalized warnings about the subprime sector are insufficient to alert corporate directors to internal wrongdoing (In re Am. Int'l Grp., Inc. Derivative Litig., 700 F Supp 2d 419, 437 [SD NY 2010]; In re Citigroup Inc. S'holder Derivative Litig., 2009 WL 2610746, at *6 [SD NY 2009]), particularly in light of the complaint's assertion that the Board was assured that S&P was rating transactions with great analytical rigor (Compl., ¶ 124).

Alternatively, plaintiffs argue that they were excused from making a demand because a majority of the Board was interested in S&P's misconduct. A director is "interested," and therefore unable to act impartially with respect to a pre-suit demand, when he or she either: (1) will receive a direct financial benefit from the transaction which is different from the benefit to shareholders generally; or (2) lacks independence because he or

she is controlled by an interested director (Marx v Akers, 88 NY2d at 200).

Plaintiffs claim that the Board is interested because its members are likely to be held liable for S&P's wrongdoing (Compl., ¶¶ 29, 287, 290, 294, 299). This conclusory claim is insufficient to establish that demand is futile (Wandel v Eisenberg, 60 AD3d 77, 80 [1st Dept 2009]).

They next argue that director Robert McGraw is interested because he is controlled by his brother Harold McGraw III who is an interested director because, as McGraw-Hill's President and CEO, his compensation is tied to McGraw-Hill's revenues which were bolstered by S&P's fraudulent ratings practices. This argument is equally unavailing. This challenged compensation model is a common practice for chief executive officers, and McGraw-Hill's mere utilization of it is not a basis to support an overreaching assertion. Moreover, as defendants note, the complaint does not implicate Harold McGraw III in the alleged wrongdoing at S&P. Though the complaint alleges that Harold McGraw III discussed the rapid growth of S&P's ratings business and repeated statements from S&P employees that mechanisms were in place to ensure ratings were accurate (Compl., ¶¶ 54-59, 111-112, 204), plaintiffs fail to allege in any non-conclusory

fashion that he had reason to believe these statements were false.

Plaintiffs also argue that Robert McGraw, as well as Peterson, are interested because they do not meet the independence requirements of the New York Stock Exchange ("NYSE") (Compl., ¶ 296). A lack of independence under the NYSE's standards "does not [automatically] mean these directors lack independence sufficient to disable them from fairly assessing" a demand, however (<u>In re Bank of Am. Corp. Secs., Derivative & ERISA Litig.</u>, 757 F Supp 2d 260, 335 [SD NY 2010]), and plaintiffs do not plead how the NYSE's determination relates to the matter at issue -- <u>i.e.</u>, S&P's fraudulent ratings.

Next, plaintiffs argue that directors Bischoff, Jacoby, Rake, and Rust are interested because each is affiliated with a company to which McGraw-Hill provides credit ratings services and data subscriptions, among other services (Compl., ¶ 297). Similarly, plaintiffs argue that Bischoff is not independent because he was Chairman of a Citigroup subsidiary from 2000 to 2009, and acted as CEO of Citigroup from November 2007 through December 2007, and S&P fraudulently rated Citigroup CDOs (Compl., ¶ 26). Plaintiffs, however, fail to explain how these affiliations compromise the directors' independence in evaluating

a demand on the Board, let alone establish that they are interested in S&P's misconduct (Sec. Police and Fire Professionals of Am. Retirement Fund v Mack, 93 AD3d 562, 564 [1st Dept 2012] [Morgan Stanley shareholders' conclusory allegation that Morgan Stanley conducted "significant" amount of business with outside director's company did not establish lack of independence of outside director]).

Accordingly, plaintiffs failed to adequately plead demand futility so as to be excused from complying with BCL 626(c)'s demand requirement. As such, defendants' motion to dismiss the complaint is granted, and it is dismissed. Nonetheless, even if demand were deemed to be futile, for the reasons that follow, plaintiffs fare no better in the outcome.

**II. Statute of Limitations**

A six-year statute of limitations applies to actions brought by, or on behalf of, a corporation against present or former corporate director or officer (CPLR 213(7); Oxbow Calcining USA Inc. v Am. Indus. Partners, 96 AD3d 646, 651-52 [1st Dept 2012]; Sardanis v Sumitomo Corp., 279 AD2d 225, 230 [1st Dept 2001]). Plaintiffs allege that the Individual Defendants are either directors or officers (Compl., ¶ 1). Accordingly, given that

plaintiffs commenced this action on August 3, 2015, their claims accruing prior to August 3, 2009 would be time-barred.

A tort claim "accrues as soon as the claim becomes enforceable, i.e., when all elements of the tort can be truthfully alleged in a complaint" (IDT Corp. v Morgan Stanley Dean Witter & Co., 12 NY3d 132, 140-41 [2009] [internal quotations omitted]). As the elements of a cause of action to recover damages for breach of fiduciary duty are: (1) the existence of a fiduciary relationship; (2) misconduct by the defendant; and (3) damages directly caused by the defendant's misconduct (Baumann v Hanover Community Bank, 100 AD3d 814, 817 [2d Dept 2012]), plaintiffs' claims "[are] not enforceable until damages are sustained" (IDT Corp. v Morgan Stanley Dean Witter & Co., 12 NY3d 132, 140-41 [2009]).

Plaintiffs argue that damages could not be calculated until McGraw-Hill's settlements of the DOJ and State Actions, and, therefore, their claims only accrued once these actions were settled in 2015. This argument is unavailing.

The breach of fiduciary duty claims relating to S&P's RMBS and CDO ratings from 2004 to 2007 accrued prior to August 2009. The record demonstrates that by that point in time S&P was already being investigated by various state attorneys general

relating to its RMBS ratings and the SEC had issued a report discussing the failure of the ratings agencies internal controls (Compl., ¶¶ 216, 218). Moreover, by January 8, 2009, another shareholder of McGraw-Hill had made a demand and commenced a derivative lawsuit in the Southern District of New York, Teamsters Allied Benefit Funds v McGraw, et al., No. 09 Civ. 140 (PGG), alleging many of the same claims of wrongdoing.

Plaintiffs, nonetheless, argue that damages accrued in 2015, after the settlement of the DOJ and State Actions, because at that time and only then that damages could be quantified. This quantification argument is undercut by plaintiffs' allegations that the state investigations and the SEC's report harmed the company by causing, inter alia, lost revenue and reputational loss (Compl., ¶¶ 302, 309). Such harm satisfies the element of damages required for a breach of fiduciary duty claim (Diamond v Oreamuno, 24 NY2d 494, 496 [1969]). Given that these damages accrued once these investigations began (or, at the latest, once the SEC released its report in July 2008), long before August 2009, plaintiffs' claims stemming from the misconduct at the heart of the investigations and lawsuit are time-barred.

The fact that McGraw-Hill sustained further losses upon the settlement of the State and DOJ Actions does not alter the

statute of limitations analysis, as the principle is well settled that "once a compensable injury has occurred, the time within which an action may be commenced may not be extended merely by the aggravation, or exacerbation, of that injury" (E. States Health & Welfare Fund v Philip Morris, Inc., 188 Misc 2d 638, 656 [Sup Ct, NY County 2000] quoting Coughlin v International Business Machines Corp., 225 AD2d 256, 260 [3d Dept 1996]; see also B. Brages Assoc. v 125 W. 21st LLC, 2014 NY Slip Op 31269 [U], 2014 WL 2116093, at *6 [Sup Ct, NY County 2014]) [statute of limitations "begins to run at the first sign of damage, even when the damage gets progressively worse"]).

Accordingly, the complaint's causes of action relating to S&P's fraudulent ratings from 2004 to 2007 are time-barred, leaving only those claims resulting from allegations of misconduct by S&P occurring between 2010 and 2014 (See Compl., ¶¶ 208-214, 228-234). As to those claims for that time period, the question that remains is whether plaintiffs have sufficiently pleaded facts to state a cause of action.

**III. Breach of Fiduciary Duty**

Plaintiffs have failed to adequately plead that defendants breached their fiduciary duties to McGraw-Hill. A cause of action sounding in breach of fiduciary duty must be pleaded with

particularity (CPLR 3016[b]; Palmetto Partners, L.P. v AJW Qualified Partners, LLC, 83 AD3d 804, 808 [2d Dept 2011]). As each defendant is entitled to notice of "the material elements of each cause of action" against him or her (CPLR 3013), plaintiffs must allege the elements of breach of fiduciary duty as to each defendant individually (Aetna Cas. & Sur. Co. v Merchants Mut. Ins. Co., 84 AD2d 736, 736 [1st Dept 1981]; Goldin v Tag Virgin Islands, Inc., 2014 WL 2094125 [NY Sup 2014]]).

Here, the complaint addresses its claims to either the Director Defendants or the Officer Defendants (or the Individual Defendants as a whole), but nowhere does it particularize the claims as to each defendant individually (Compl., ¶ 304-328). As a result, the complaint must be dismissed (Aetna Cas. & Sur. Co. v Merchants Mut. Ins. Co., 84 AD2d 736, 736 [1st Dept 1981]; Goldin v Tag Virgin Islands, Inc., 2014 WL 2094125 [NY Sup 2014]]).

The cases plaintiffs rely on, In re Comverse Tech., Inc., 56 AD3d 49, 52-53 (1st Dept 2008) and Pludeman v N. Leasing Sys., Inc., 10 NY3d 486 (2008) do not compel a different outcome. The Appellate Division's decision in In re Comverse Tech., Inc. did not address whether the plaintiff had pleaded a breach of fiduciary duty with sufficient particularity as to each

individual director, but was merely limited to whether demand futility had been pleaded with particularity (In re Comverse Tech., Inc., 56 AD3d at 52-53). Moreover, the complaint in that action did, in fact, specify the purported wrongful acts of each director (Id.).

In Pludeman v N. Leasing Sys., Inc., the Court of Appeals excused the plaintiffs' failure to particularize their claims as to the defendants because their allegation of a nationwide scheme could not have been effected without the defendants' involvement was sufficient to permit a reasonable inference of the alleged wrongful conduct by each of the defendants (Pludeman v N. Leasing Sys., Inc., 10 NY3d a 489-490, 493). Here, by contrast, the fraudulent ratings at issue do not necessarily give rise to "the reasonable inference that the officers and directors, as individuals and in the key positions they held, knew of and/or were involved in the fraud" (Pludeman v N. Leasing Sys., Inc., 10 NY3d at 493).

In addition, unlike Pludeman, in which information necessary to prosecute the action was outside of the plaintiff's control at the time the complaint was filed, plaintiffs have a substantial amount of information concerning S&P's misconduct, including thousands of pages of board materials resulting from their books

and records demand (Compl. ¶ 249), as well as a report issued by the United State Senate's Permanent Subcommittee on Investigations (Compl., pp. 1-2). Despite this information, they remarkably failed to plead sufficient and particular facts to support a breach of fiduciary duty claim against defendants.

Accordingly, plaintiffs' breach of fiduciary duty claims are dismissed.

**IV. Certificate of Incorporation**

The Director Defendants are also exempt from liability under the exculpatory clause set forth in McGraw-Hill's Certificate of Incorporation. The Certificate of Incorporation provides, in relevant part, that "[n]o director of the Corporation shall be personally liable to the Corporation or its shareholders for damages for any breach of duty in such capacity except to the extent that such elimination or limitation of liability is expressly prohibited by [the BCL] (McGraw-Hill Certificate of Incorporation, Article XI, Markley Aff. in Supp., Ex. 1).

Such an exculpatory clause is valid under BCL § 402(b) as long as it does not eliminate or limit liability for acts or omissions that were in bad faith or involved intentional misconduct or a knowing violation of law (<u>Teachers' Retirement System v Welch</u>, 244 AD2d 231, 231-32 [1st Dept 1997]). As

discussed supra, plaintiffs have not sufficiently alleged that the Director Defendants engaged in such actions or omissions. Under these circumstances, McGraw-Hill's exculpatory clause bars the claims against the Director Defendants.

Finally, plaintiffs' application in a footnote in their opposition brief for leave to amend their complaint is denied (Board of Managers of the Vetro Condominium v. 107/31 Development Corp., 2014 WL 5390548 [Sup Ct, NY Sup 2014] [request for leave to amend in a footnote in opposition papers denied as improper]).

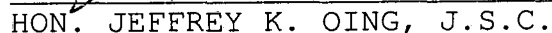
Accordingly, it is

ORDERED that defendants' motion to dismiss plaintiffs' complaint is granted, and it is dismissed; and it is further

ORDERED that the Clerk is respectfully directed to enter judgment of dismissal accordingly.

This memorandum opinion constitutes the decision and order of the Court.

Dated: 12|21|16



HON. JEFFREY K. OING, J.S.C.

JEFFREY K. OING
J.S.C.