DELAWARE DISMISSES CLAIMS ALLEGING FAILURE TO MONITOR RISK: IN RE CITIGROUP INC. SHAREHOLDER DERIVATIVE LITIGATION

February 27, 2009

To Our Clients and Friends:

Stating that "we must not let our desire to blame someone for our losses make us lose sight of the purpose of our law," Delaware Chancellor William B. Chandler III dismissed claims that directors and officers of Citigroup Inc. breached their fiduciary duties by, among other things, failing to monitor and manage Citigroup's risks from exposure to subprime mortgage assets in the face of "red flags" signaling problems. The court also dismissed a claim that defendants were liable for corporate waste for allowing Citigroup to repurchase its stock at "artificially inflated prices," although it declined to dismiss a waste claim challenging an agreement providing benefits to Citigroup's departing CEO.

The case, *In re Citigroup Inc. Shareholder Derivative Litigation* (C.A. No. 3338-C (Feb. 24, 2009), represents a strong endorsement of the business judgment rule and of Delaware courts' reluctance to second-guess directors' business decisions. It also underscores the extremely high hurdle faced by plaintiffs alleging *Caremark* claims based on directors' failure to exercise oversight, particularly when the claim is that directors should be liable for failing to monitor the corporation's ordinary business operations. The Chancellor wrote that in order to meet this hurdle plaintiffs would need to plead particularized factual allegations raising a reasonable doubt that the director defendants acted in good faith and ultimately prove that they acted in bad faith.

The plaintiffs' *Caremark* claim that the defendants failed to properly monitor Citigroup's business risk departed from the typical *Caremark* claim, which alleges a failure to monitor employee misconduct or violations of law. While acknowledging that directors are obligated to implement and monitor systems of oversight, Chancellor Chandler stated that "this obligation does not eviscerate the core protections of the business judgment rule – protections designed to allow corporate managers and directors to pursue risky transactions without the specter of being held personally liable if those decisions turn out poorly." The Chancellor stated that it was "almost impossible" for a court to determine whether directors properly evaluated risk, and that attempting to do so "would involve courts in conducting hindsight evaluations of decisions at the heart of business judgments of directors" – precisely what the business judgment rule was designed to prevent.

Turning to the corporate waste claims, the court found the plaintiffs had failed to explain how buying stock at the market price – the price at which "ordinary and rational businesspeople"

traded the stock – could be, as required for a waste claim to proceed, an exchange so one-sided that "no business person of ordinary, sound judgment could conclude that the corporation had received adequate consideration." However, Chancellor Chandler declined to dismiss a waste claim concerning a letter agreement that provided Citigroup's departing CEO with $68 million and an office, an administrative assistant and a car and driver for up to five years in exchange for non-competition, non-disparagement and non-solicitation agreements and a release of claims from the CEO. The court observed that directors' discretion in setting executive compensation was "not unlimited" and that the Delaware Supreme Court had indicated that the "outer limit" was reached if the "compensation is so disproportionately large as to be unconscionable and constitute waste." With little information about how much additional compensation the letter agreement provided and the "real value, if any," of the CEO's promises, Chancellor Chandler found there was a "reasonable doubt" as to whether the compensation was beyond the outer limit described by the Delaware Supreme Court.

The decision should reassure directors of Delaware corporations that the business judgment rule remains in good health, and, in particular, that shareholders will not easily be able to subject corporate risk-taking to scrutiny through the lens of hindsight – a source of considerable comfort to directors in light of recent events. However, it does remind us that courts may not be immune to the prevailing desire for closer inspection of compensation issues.

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