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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

IN RE WELLS FARGO & COMPANY SHAREHOLDER DERIVATIVE LITIGATION

Lead Case No. 3:16-cv-05541-JST

WELLS FARGO & COMPANY'S NOTICE OF MOTION AND MOTION TO DISMISS THE CONSOLIDATED AMENDED VERIFIED STOCKHOLDER DERIVATIVE COMPLAINT FOR FAILURE TO ADEQUATELY PLEAD DEMAND FUTILITY; MEMORANDUM OF POINTS & AUTHORITIES IN SUPPORT

The Honorable Jon S. Tigar
Hearing: May 4, 2017 at 2:00 p.m.

TO ALL PARTIES AND THEIR COUNSEL OF RECORD:

PLEASE TAKE NOTICE that on May 4, 2017, at 2:00 p.m., or as soon thereafter as the matter may be heard in the United States District Court for the Northern District of California, San Francisco Courthouse, Courtroom 9, located at 450 Golden Gate Avenue, San Francisco, California, 94102, nominal defendant Wells Fargo & Company, through its undersigned counsel, will, and hereby does, move to dismiss the Consolidated Amended Verified Stockholder Derivative Complaint, pursuant to Rules 12(b)(6) and 23.1 of the Federal Rules of Civil Procedure for failure to make a pre-suit demand on Wells Fargo's Board of Directors or adequately to plead that the demand requirement was excused.

This Motion is based on this Notice, the supporting Memorandum of Points and Authorities, the Declaration of Brendan P. Cullen filed concurrently herewith, the accompanying Request for Judicial Notice, the complete files and records in this action, and any additional material and arguments as may be considered in connection with the hearing.

DATED: March 17, 2017

Respectfully submitted,

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Nominal defendant Wells Fargo & Company ("Wells Fargo" or the "Company") respectfully submits this Memorandum of Points and Authorities, together with the Declaration of Brendan P. Cullen ("Decl.") and attached exhibits, in support of its motion to dismiss the Consolidated Amended Verified Stockholder Derivative Complaint (the "Complaint") for failure to plead demand futility.[1]

PRELIMINARY STATEMENT

Shareholders can only pursue the claims of a Delaware corporation in extraordinary circumstances. This is not one of them. The Complaint is arrestingly lengthy, as complaints like it usually are. The Complaint demonstrates that the sales-practices issues that were the subject of Wells Fargo's settlements with the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau, and the City Attorney of Los Angeles have received a great deal of attention since September 2016. This attention – from other litigants or the press or regulators or some in Congress – might well indicate that the sales-practices issues are serious or significant. It is irrelevant, however, to the question whether the corporation's claims arising from those issues – if any – may be asserted by the corporation (as directed by its Board of Directors) or by a shareholder.

Delaware law – which governs here because Wells Fargo is a Delaware corporation – requires that, before Plaintiffs file suit asserting claims on behalf of the corporation, they make a demand on Wells Fargo's Board that it investigate and, if warranted, pursue the claims that Plaintiffs assert. Plaintiffs failed to make the required demand, alleging that the demand requirement should be excused as futile because a majority of Wells Fargo's Directors are disqualified from assessing any demand due to self-interest or lack of independence. Plaintiffs principally allege that a majority of Directors are disqualified because they face a substantial likelihood of liability for failing to monitor Wells Fargo. This theory of director liability "is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment." *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996). "Claims asserted under *Caremark* must meet an exceptionally high [pleading] burden." *In re Am. Apparel, Inc. 2014 Deriv. S'holder Litig.*, 2015 WL 12724070, at *17 (C.D. Cal.

[1] The Individual Defendants join this motion by way of separate joinders. Pursuant to an agreement among the parties, the Individual Defendants may present further motions addressing the adequacy of the Complaint's pleading of claims on bases other than demand futility, if necessary, following a decision on the threshold demand-futility issue.

Apr. 28, 2015). Plaintiffs were obliged to allege particularized facts demonstrating that each of at least eight of Wells Fargo's 15 Directors "knew that they were not discharging their fiduciary obligations." *Stone* v. *Ritter*, 911 A.2d 362, 370 (Del. 2006). As then-Vice Chancellor (now Chief Justice) Leo Strine, has written, "director liability for failure to monitor require[s] a finding that the directors acted with the state of mind traditionally used to define the mindset of a disloyal director – bad faith – because their indolence was so persistent that it could not be ascribed to anything other than a knowing decision not to even try to make sure the corporation's officers had developed and were implementing a prudent approach to ensuring law compliance." *Desimone* v. *Barrows*, 924 A.2d 908, 935 (Del. Ch. 2007).

The Complaint is long on dudgeon and profligate in its accusations of Director wrongdoing and knowledge. But it fails to allege particularized facts showing that the Directors knowingly breached their duties to Wells Fargo. The Complaint should be dismissed.

STATEMENT OF FACTS AND ALLEGATIONS OF THE COMPLAINT

Wells Fargo, a Delaware corporation headquartered in San Francisco (Compl. ¶ 66), is one of the world's largest financial services firms. It offers retail, commercial and corporate banking services, primarily in the United States. (*See* Decl. Ex. O, at 36.[2]) Wells Fargo employs approximately one in every 600 working Americans, totaling more than 260,000 people in four divisions (Community Banking, Consumer Lending, Wealth and Investment Management, and Wholesale, Commercial and International Banking). (*Id.* at 36, 51.) The Community Banking division, in which the sales practices issues arose, employs approximately 100,000 people. (Decl. Ex E, at 7.) There are 6,200 Wells Fargo bank branches in the United States. (Decl. Ex. P.) If Wells Fargo were a city and its employees residents, it would be more populous than 36 U.S. state capitals and would be the most populous city in 18 U.S. states. (*See* Decl. Exs. Q, R.) In 2016, Wells Fargo earned $88.3 billion in revenues and $21.9 billion in net income. (Decl. Ex. O, at 40.)

On September 8, 2016, the Consumer Financial Protection Bureau, the Office of the

[2] Exhibits discussed herein are public documents appropriate for judicial notice. *See Sec. & Exch. Comm'n* v. *Bardman*, 2016 WL 6276995, at *13 (N.D. Cal. Oct. 27, 2016) ("Matters of public record, including public filings made with the SEC, may be judicially noticed."). Plaintiffs plead that the documents referenced in the Complaint set forth the facts establishing that demand is futile; thus, the Court should consider those documents in their entirety and in context. *See Reiter* v. *Fairbank*, 2016 WL 6081823, at *12-13 (Del. Ch. Oct. 18, 2016).

Comptroller of the Currency ("OCC") and the Los Angeles City Attorney simultaneously announced settlements with Wells Fargo stemming from certain sales practices related to the unauthorized opening of customer accounts by certain of Wells Fargo's bank branch employees. (*See* Compl. ¶¶ 9-14.) Wells Fargo entered into these settlements without admitting or denying wrongdoing. (Compl. ¶ 13 & n.12.) Its former CEO, John Stumpf, testified before the Senate Banking Committee on September 20, 2016, and before the House Financial Services Committee on September 29, 2016, on matters related to the facts underlying these settlements. (Compl. ¶¶ 154, 169, 209, 412.)

In the wake of the announcement, Wells Fargo's Board took numerous actions. On September 25, 2016, the Board created an Oversight Committee of outside Directors (the "Oversight Committee") to conduct "an independent investigation into the Company's retail banking sales practices and related matters." (Decl. Ex. F.)[3] At the same time, defendant Tolstedt left the Company and Tolstedt and Stumpf forfeited approximately $19 million and $41 million, respectively, in stock compensation. (*Id.*) On October 12, 2016, Stumpf retired. (Decl. Ex. G, at 2.) The Board elected Sloan to the Board and appointed him as CEO, and elected Sanger as non-executive Chairman and Duke as non-executive Vice Chair. (*Id.*) The Board subsequently amended the Company's by-laws to require that the chair and vice chair roles be held by outside directors. (Decl. Ex. L, at 2.) Throughout the fourth quarter of 2016 and first quarter of 2017, Wells Fargo has filed disclosures with the SEC discussing its key actions with regard to sales practices, including the Board's investigation, the Board's termination of four Community Banking executives for cause in early 2017, and the Board's decision not to pay bonuses to several senior executives for 2016. (*See* Decl. Exs. F, H at 3-12, I at 3-4, M, N, O at 56.) Those filings contain in-depth reviews of the sales practices at issue and detail Wells Fargo's steps to identify unauthorized accounts and refund more than $3 million to potentially affected customers. (*Id.*)

On September 21, 2016, the first derivative action was filed in California state court, followed quickly by 16 similar derivative complaints filed in this Court and the San Francisco Superior Court, all alleging claims arising from Wells Fargo's sales practices. (Decl. Ex. J.) On February 24, 2017, Plaintiffs filed the current Complaint, asserting causes of action against numerous defendants, including

[3] The Oversight Committee recently announced that it intends to disclose the findings of its investigation by April 25, 2017. (Decl. Ex. M.)

all members of the Board at the time this action was instituted. (Compl. ¶¶ 70-91.) The Complaint alleges 11 causes of action for (1) breach of fiduciary duty; (2) unjust enrichment; (3) insider selling; (4) violation of Section 14(a) of the Exchange Act; (5) violation of Section 10(b) of the Exchange Act; (6) violation of Section 20(a) of the Exchange Act; (7) violation of Section 29(b) of the Exchange Act; (8) violation of California Corporations Code § 25402; (9) violation of California Corporations Code § 25403; (10) corporate waste; and (11) contribution and indemnification. (Compl. ¶¶ 524-96.) The first, second, fourth, fifth, seventh, ninth and tenth causes of action are alleged against the Directors. (*Id*.)

The Wells Fargo Board. At the time the first complaint was filed, Wells Fargo's Board had 15 members: Baker, Chao, Chen, Dean, Duke, Engel, Hernandez, James, Milligan, Peña, Quigley, Sanger, Stumpf, Swenson and Vautrinot.[4] (*See* Compl. ¶ 91.) The Wells Fargo Board is composed of individuals with extensive experience in banking, corporate governance and management, including a former governor of the Federal Reserve Board and former chairwoman of the American Bankers' Association (Vice Chairwoman Duke), a business school dean emeritus (Milligan), the CEO emeritus of Deloitte (Quigley), a retired Major General and Commander of the United States Air Force (Vautrinot), and 10 directors with extensive executive experience as CEOs and chairpersons of unaffiliated boards of directors for Fortune 500 firms. (Decl. Ex. B, at 4-11.) Chairman Sanger is the former CEO and chairman of General Mills. (*Id.* at 9.) Two outside Directors joined the Board in 2015 (Duke and Vautrinot). (*Id.* at 6, 11.) CEO Sloan, like his predecessor, Stumpf, is the only director employed by the Company.

Nearly all of the allegations in the Complaint are focused on the Defendants who are or were members of Wells Fargo management. For much of the Complaint, Plaintiffs broadly lump the defendants together as "Officer Defendants" and "Director Defendants" to attempt to infer what a majority of Board members allegedly "knew." (*See*, *e.g.*, Compl. ¶ 93 ("Because of their positions of control and authority as directors or officers of Wells Fargo, Defendants were able to and did, directly or indirectly, exercise control over the wrongful acts . . .").)

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[4] Plaintiffs note that Stumpf resigned from Wells Fargo after the filing of the action and was replaced by CEO Sloan before the filing of the present Complaint. (Compl. ¶ 70.) For purposes of demand futility, the focus is on "the board of directors 'sitting at the time the complaint is filed.'" *Rosenbloom* v. *Pyott*, 765 F.3d 1137, 1148 (9th Cir. 2014) (citation omitted). The current Board is made up of 16 directors, including two newly elected outside directors, Peetz and Sargent. Chao resigned from the Board to serve as U.S. Secretary of Transportation. (Compl. ¶ 77.)

Plaintiffs refer to and quote extensively from dozens of documents. Those documents set forth the following timeline of remedial actions taken by the Company:

> In 2011, a dedicated team began to engage in proactive monitoring of data analytics, specifically for the purpose of rooting out sales practice violations. In 2012, [Wells Fargo] began reducing sales goals that team members would need to qualify for incentive compensation. In 2013, [Wells Fargo] created a new corporate-wide enterprise oversight for sales practices. In 2014, [Wells Fargo] further revised [its] incentives compensation plans, to align pay with ethical performance. In 2015, [the Company] added more enhancements to [its] training materials, further lowered goals, and began a series of town hall meetings, to re-enforce the importance of ethical leadership and always putting [its] customers first.

(Decl. Ex. E, at 5; *see* Compl. ¶ 247, n.11.)

Demand Futility Allegations. The Complaint includes some detailed allegations concerning improper sales practices – including the number of employees dismissed for ethics violations, the number of accounts potentially affected and the details of certain investigations and lawsuits. Wells Fargo or its regulators have reported much of this information. What the Complaint fails to plead, however, are facts showing the interestedness and lack of independence of the Board. Instead, the Complaint merely repeatedly asserts that the Directors purportedly had knowledge of or involvement in improper sales practices.

For example, Plaintiffs make the conclusory allegation that the Director Defendants "knew of or recklessly disregarded myriad facts relating to [the] scheme" (*id*. at ¶ 514), but never set forth with specificity how any Director personally came to know about the alleged "scheme" or when or how a majority of Directors "affirmatively adopted, implemented and condoned" it. (*Id*. at ¶ 478.) Plaintiffs include numerous paragraphs as the basis to allege a "pattern of conduct showing a wholesale abandonment" of the Directors' fiduciary duties, including (a) allowing retail bank employees to engage in the "pervasive" scheme, (b) allowing insiders to engage in insider selling while they knew of the alleged scheme, (c) "perpetuating woefully inadequate controls" which "allowed the illicit account-creation scheme to begin and persist for years," (d) "causing Wells Fargo to file materially false and misleading SEC filings," (e) "approving a share repurchase program through which Wells Fargo bought back millions of shares of stock at artificially inflated prices," (f) awarding "inflated compensation packages" to officers, and (g) "concealing the illicit account-creation scheme." (Compl. ¶¶ 479-81.) Notwithstanding the lengthy recitation of alleged wrongs, the Complaint does not allege when or how

the Directors came to know the things that Plaintiffs allege that they knew – and other parts of the Complaint confirm that the allegations of Director knowledge are conclusory inferences. (*See*, *e.g.*, Compl. ¶ 482 (generalized claims of wrongdoing "indicate" the Directors' scienter).)

Finally, Plaintiffs allege that the five Directors on the Human Resources Committee lack independence because they "knew or recklessly disregarded that they were approving the Officer Defendants' compensation in a manner that was not a valid exercise of business judgment." (Compl. ¶ 514.) Plaintiffs further allege that the Human Resources Committee "abdicat[ed]" its "responsibility with respect to clawbacks" of compensation from Stumpf and Tolstedt because it "only 'agreed' with Stumpf's recommendation 'that he forfeit all of his outstanding unvested equity awards,' as well as his 2016 bonus and salary," rather than firing him for cause (to the same effect). (Compl. ¶ 516-17.)

STANDARD ON THIS DEMAND FUTILITY MOTION

The requirement that a shareholder make a demand on a company's board of directors before bringing claims that belong to the Company is a cornerstone of Delaware corporate law, derived from the "cardinal precept" that "directors, rather than shareholders, manage the business and affairs of the corporation." *Aronson* v. *Lewis*, 473 A.2d 805, 811 (Del. 1984).[5] The demand requirement exists to "insure that a stockholder exhausts his intracorporate remedies" and "provide[s] a safeguard against strike suits." *Id.* at 811-12. The "hurdle of proving demand futility serves an important policy function of promoting internal resolution, as opposed to litigation, of corporate disputes and grants the corporation a degree of control over any litigation brought for its benefit." *Rattner* v. *Bidzos*, 2003 WL 22284323, at *7 (Del. Ch. Sept. 30, 2003). This case provides an excellent example of the wisdom of this rule. According to Plaintiffs, Wells Fargo faces a crisis related to the sales-practices issues, involving litigations in multiple fora and investigations by numerous regulators and Congressional committees. (Compl. ¶ 507.) The Company's responses to the numerous issues that have arisen from this situation require weighing a vast number of considerations and the views of many constituencies – regulators, shareholders, customers, potential customers, employees, and potential employees, to name

[5] Delaware law applies to the determination whether Plaintiffs have pled demand futility adequately because Wells Fargo is a Delaware corporation. *See Charter Twp. of Clinton Police & Fire Ret. Sys.* v. *Martin*, 219 Cal. App. 4th 924, 934-35 (2013); *Villari* v. *Mozilo*, 208 Cal. App. 4th 1470, 1478 n.9 (2012) ("Delaware substantive law applies in this case pursuant to the internal affairs doctrine . . . which provides that the law of the place of incorporation governs the liability of directors to the corporation and its shareholders.").

just a few. Many of these same considerations would – or should – weigh on the decision whether, when, and how Wells Fargo will pursue any claims of its own that arise from the sales-practices issues. Plaintiffs – whose only stake in the outcome of this litigation is the stock of Wells Fargo that they own and who do not have to answer to (or worry about) any Wells Fargo regulator, customer, or employee – seek to take over this decision and displace the collective judgment of the highly experienced members of the Board.

To establish that this case is the rare one in which demand is excused, Plaintiffs must plead with particularity either that a majority of the Board (here, eight of 15 Directors) was interested in the outcome of the claims at issue, or that a majority is insufficiently independent with respect to a decision on whether to bring suit. *Rales* v. *Blasband*, 634 A.2d 927, 936 (Del. 1993).[6]

Interestedness. As relevant here, a plaintiff can plead interestedness on the part of a board by pleading particularized facts showing that "the directors face a 'substantial likelihood' of personal liability," such that "their ability to consider a demand impartially is compromised." *Rattner*, 2003 WL 22284323, at *12 (*quoting Guttman* v. *Huang*, 823 A.2d 492, 501 (Del. Ch. 2003) (internal quotations omitted)); *see also South* v. *Baker*, 62 A.3d 1, 14-15 (Del. Ch. 2012) (holding that "a stockholder must plead facts establishing a sufficient connection between the corporate trauma and the board such that at least half of the directors face a substantial likelihood of personal liability").[7] A "substantial likelihood" of liability is not a "mere threat" of liability. *See Rales*, 634 A.2d at 936. Plaintiffs cannot establish a disqualifying interest simply by naming a director as a defendant or even by alleging that the director approved the transaction or decision at issue. *See Brehm* v. *Eisner*, 746 A.2d 244, 257 n.34 (Del. 2000). Plaintiffs cannot "displace the board's authority [over the corporation's claims] simply by describing the calamity and alleging that it occurred on the directors' watch." *South*, 62 A.3d at 14-15 (quoting *La. Mun. Police Empls.' Ret. Sys.* v. *Pyott*, 46 A.3d 313, 340 (Del. Ch. 2012), *rev'd on other*

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[6] The Complaint comes nowhere close to establishing that any Director, much less a majority of the 15 Directors, faces a substantial likelihood of liability. For the sake of simplicity, references to "Director(s)," where not otherwise specified, refer to outside Directors.

[7] Plaintiffs do not appear to have attempted this, but director interestedness also can be pled with particularized facts showing that the wrongdoing at issue resulted in a director receiving a material "personal financial benefit . . . not equally shared by the stockholders," *Rales*, 634 A.2d at 936 (citation omitted), and that the benefit is significant enough "to have made it improbable that the director could perform her fiduciary duties to the . . . shareholders without being influenced by her overriding personal interest." *Orman* v. *Cullman*, 794 A.2d 5, 23 (Del. Ch. 2002) (citation omitted).

grounds, 74 A.3d 612 (Del. 2013)).

The facts showing that a director faces a "'substantial likelihood' of personal liability" must be pled with particularity. *See Aronson*, 473 A.2d at 814-15. Generalized, non-specific allegations fail to meet this burden. *Desimone*, 924 A.2d at 943. Further, Plaintiffs must "plead *facts specific to each director*, demonstrating that at least half of them could not have exercised disinterested business judgment in responding to a demand." *Id*. (emphasis added).

The typical plaintiff attempting to plead that his or her failure to make a demand was excused as futile faces a nearly insurmountable hurdle. The hurdle here is higher still.

First, pursuant to Delaware General Corporation Law § 102(b)(7), Wells Fargo's charter exculpates its Directors from liability for breaches of fiduciary duty, except as to acts taken in bad faith or intentional misconduct. (Decl. Ex. P, at 7.) Accordingly, the Directors face no likelihood of personal liability for negligence or any nonintentional breach of their duty of care. In the face of this exculpatory clause, Plaintiffs can only plead the requisite "'substantial likelihood' of personal liability" if they can allege "with particularity actual director involvement in a decision or series of decisions that violated positive law," such that the Directors "knowingly" breached their fiduciary duties, or that the Directors "consciously failed to act after learning about evidence of illegality" through a "red flag." *South*, 62 A.3d at 15; *see also In re Autodesk, Inc., S'holder Deriv. Litig.*, 2008 WL 5234264, at *9–10 (N.D. Cal. Dec. 15, 2008) (where corporation "has adopted an exculpatory provision under Delaware law, liability is foreclosed for all but the most egregious breaches of duty – self-dealing [ ] and intentional bad faith").

Second, the thrust of Plaintiffs' demand futility allegations is that the Directors face a substantial likelihood of liability for failing to exercise oversight over Wells Fargo. (*See*, *e.g.*, Compl. ¶¶ 9, 96, 99, 284, 377, 475, 481, 483.) The only such claims that exist under Delaware law are "*Caremark*" claims. *Caremark*, 698 A.2d at 967. Delaware courts describe the *Caremark* "failure to monitor" claim as "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment," *Caremark*, 698 A.2d at 967; *Stone*, 911 A.2d at 372, and make clear that it is viable only when there "the directors acted with the state of mind traditionally used to define the mindset of a disloyal director – bad faith." *Desimone*, 924 A.2d at 935.

A *Caremark* claim can be pled by alleging particularized facts demonstrating either "(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. In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations." *Stone*, 911 A.2d at 370 (emphases added). It is not entirely clear, but Plaintiffs appear to allege the second sort of *Caremark* failing – the failure to monitor. Plaintiffs can plead a *Caremark* claim only if they allege that the Board "consciously failed" to monitor Wells Fargo's systems and controls to such an extent that they "knew that they were not discharging their fiduciary obligations." *Id*. at 372. Merely pleading that Wells Fargo officers and employees have misbehaved will not satisfy this obligation. Delaware courts have long recognized that "most of the decisions that a corporation, acting through its human agents, makes are, of course, not the subject of director attention." *Id*. (quoting *Caremark*, 698 A.2d at 968). "[O]rdinary business decisions that are made by officers and employees deeper in the interior of the organization can . . . vitally affect the welfare of the corporation and its ability to achieve its various strategic and financial goals." *Caremark*, 698 A.2d at 968. Thus, "directors' good faith exercise of oversight responsibility may not invariably prevent employees from violating criminal laws, or from causing the corporation to incur significant financial liability, or both[.]" *Stone*, 911 A.2d at 373.

Because of the exculpatory clause and because Plaintiffs bring *Caremark* claims, the only way that Plaintiffs can adequately plead that a majority of the Directors face a "'substantial likelihood' of personal liability" is to allege specific facts establishing that each Director acted with "scienter, *i.e.* that they had 'actual or constructive knowledge' that their conduct was legally improper," *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 125 (Del. Ch. 2009) (citing *Wood* v. *Baum*, 953 A.2d 136, 141 (Del. 2008)), or, as to the waste claim, bad faith, which is "very rarely found." *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 748 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006).

Independence. A director is not independent for purposes of assessing demand futility if he is "beholden" to the subject of the claims such that the director is unable to base his decisions on the "corporate merits of the subject before the board rather than extraneous considerations or influences."

Rales, 634 A.2d at 936 (*quoting Aronson*, 473 A.2d at 816). Directors who are family members of senior executives or are themselves employees of a corporation are prototypical examples of those who lack independence. *See id.* at 936-37. Plaintiffs can plead lack of independence only by alleging "particularized facts sufficient to create a reasonable doubt" that most Directors are incapable of acting independently. *Id*. at 937.[8]

ARGUMENT

Plaintiffs allege that demand is futile for three primary reasons: (a) the Directors face liability for "their awareness or conscious disregard of significant red flags" concerning the sufficiency of Wells Fargo's internal controls (Compl. ¶¶ 483-512), (b) they face liability for decisions that "evidence a pattern of conduct showing a wholesale abandonment of the Director Defendants' duties" (Compl. ¶¶ 479-82), and (c) they lack "independence from Stumpf" because they approved his "excessive compensation." (Compl. ¶¶ 513-17.) None of these allegations satisfies Delaware's exacting demand-futility pleading standard.

I. PLAINTIFFS FAIL TO ALLEGE "RED FLAGS" THAT CONSTITUTE SCIENTER ESTABLISHING THAT THE DIRECTORS "UTTERLY FAILED" TO OVERSEE THE COMPANY.

Plaintiffs do not plead a factual basis for the conclusion that any Director – let alone a majority of Directors – knew that they were failing in their oversight responsibilities. The Complaint alleges six types of information supposedly "known" to the Board: (i) the Board had to have known of the dismissal of 5,300 employees (Compl. ¶¶ 50, 246); (ii) certain committees received "high-level" information concerning inquiries to the Company's EthicsLine reporting system (*see* Compl. ¶¶ 29, 154, 209); (iii) a December 2013 *L.A. Times* article on the Community Bank's sales practices was discussed with the Board (Compl. ¶¶ 163, 169); (iv) the Board was "confronted with additional red flags of misconduct when the L.A. City Attorney initiated a lawsuit" in May 2015, accompanied by a consumer class action (Compl. ¶¶ 171, 179); (v) several regulators investigated unauthorized accounts

[8] Several of Plaintiffs' causes of action (*e.g.*, for unjust enrichment, waste and mismanagement) do not independently give rise to a "substantial likelihood" of Director liability because they are merely duplicative. *Gamco Asset Mgmt., Inc.* v. *iHeartMedia, Inc.*, 2016 WL 6892802, at *19 (Del. Ch. Nov. 29, 2016) (dismissing "duplicative" unjust enrichment claims following dismissal of fiduciary duty claims because "unjust enrichment claim depends *per force* on the breach of fiduciary duty claim"); *Disney*, 907 A.2d at 748; *see also Citigroup*, 964 A.2d at 115 ("Delaware law does not recognize an independent cause of action against corporate directors and officers for reckless and gross mismanagement; such claims are treated as claims for breach of fiduciary duty.").

at various times in the past five years (Compl. ¶¶ 183-85, 220); and (vi) the OCC identified sales practices as "matters requiring attention" through its examination of Wells Fargo Bank, N.A. in 2016 (Compl. ¶ 220, *et seq.*). None of these allegations suffice to plead scienter – these allegations never supply the "who, what, when, where and how" sorts of facts that demonstrate that and how any Director, let alone a majority of Directors, came to have knowledge of systemic wrongdoing by Wells Fargo officers or employees. *See South*, 62 A.3d at 17 (dismissing case because "the complaint nowhere alleges anything that the directors were told about the incidents, [or] what the Board's response was[.]"). Plaintiffs catalogue reported misconduct by retail banking *employees*, but that alone cannot establish what the *Directors* knew about that misconduct or when they knew it. *KBC Asset Mgmt. NV* v. *McNamara*, 2016 WL 2758256, at *1 (D. Del. May 12, 2016) (finding insufficient "Complaint [that] alleges a number of bad facts, but fails to provide a basis for inferring that the requisite number of Board members were aware of the alleged red flags[.]"); *Reiter*, 2016 WL 6081823, at *13-16 (rejecting claims, in bank derivative action, that regulatory investigations and lawsuits constituted "red flags").

A. Dismissal of Employees Does Not Raise an Inference of Corporate Control Failures.

Plaintiffs allege, no fewer than seven times, that a "glaring red flag to Defendants consisted of the termination, over the span of five years, of ***more than 5,300 Wells Fargo employees*** for conduct relating to the illicit account-creation scheme." (Compl. ¶ 246 (emphasis in original), *see also id.* ¶¶ 10, 19, 50, 250, 419, 437, 505.) The Complaint, however, nowhere alleges that this information was provided to the Directors before September 2016, let alone whether it, or why it would have, struck the Directors as significant. Context is critical. In a bank with 6,200 branches, this allegation means that, on average and over roughly a five-year period, fewer than one employee per Wells Fargo branch was terminated for sales-practice-related issues. Perhaps more importantly, the allegation involves *terminated employees* – as best as can be determined from their allegations, Plaintiffs allege that employees engaged in misconduct that the Company's controls detected and that those employees received the ultimate sanction that an employer can mete out: they were dismissed. Had this information been provided to the Directors (which, again, Plaintiffs do not allege), it might well have communicated to the Directors that the controls in place were functioning properly and that the

Company was taking misconduct seriously when it discovered it. Because Plaintiffs fail to allege that this information – in any form – was ever provided to the Directors prior to September 2016, it does not assist them in pleading that any Director "consciously failed to act after learning about evidence of illegality." *South*, 62 A.3d at 15; *see In re Impax Labs., Inc. S'holder Deriv. Litig.*, 2015 WL 5168777, at *7 (N.D. Cal. Sept. 3, 2015) ("The lacuna in the plaintiffs' argument is a failure to recognize that the directors' good faith exercise of oversight responsibility may not invariably prevent employees from [causing harm to the corporation].") (quoting *Stone*, 911 A.2d at 373).[9]

B. The EthicsLine Allegations and Anecdotes of Retail Employee Misconduct Do Not Support Plaintiffs' Claims for Intentional Breach of Fiduciary Duties.

Plaintiffs focus heavily on employee calls to Wells Fargo's EthicsLine and a handful of communications from current or former employees over a period of several years as evidence of the Board's knowledge of systemic internal control failures. (*See*, *e.g.*, Compl. ¶¶ 23-26, 28, 44, 196-219.) "Handful" may be an overstatement: Plaintiffs allege one letter from 2007 (nine years before this lawsuit was filed); two emails in 2011; and a letter and emails from a single employee in 2015. (*Id.* ¶¶ 22, 28, 44.) Only the 2015 letter and emails are alleged to have been sent to the Board, and even then, they are not alleged to have been sent to the individual Board members but to an email address of unalleged ownership (BoardCommunications@wellsfargo.com) that Plaintiffs do not allege is a direct line to Wells Fargo's Directors. (*Id.* ¶ 44, 206.)[10] The existence of four employee complaints over a nine-year period in an organization as large as Wells Fargo hardly evidences the sort of systemic failure of controls that Plaintiffs must plead to support a failure of oversight claim. Indeed, the allegations concerning the communications in 2011 (which were not alleged to have been provided to the Board) sandwich the allegation that, in 2011, "[n]early 1,000 employees in the Company's retail banking

[9] To put these dismissals in further context, over the period from 2011 through 2015, between 5.9% and 6.9% of employees in the U.S. financial services sector were involuntarily discharged each year (either terminated or laid off). (*See* Decl. Ex. C.) Plaintiffs allege sales-practices-related terminations that amount to approximately 1% of Wells Fargo's Community Banking personnel and less than 0.4% of Wells Fargo's total personnel per year over the period 2011 to 2015. Without a great deal more, that does not constitute a red flag under Delaware law (though, again, Plaintiffs do not even allege that the Directors were made aware of these terminations in the first place).

[10] The 2007 letter is alleged to have been provided to the Audit and Examination Committee, though Plaintiff does not allege what current Directors served on that committee at that time (*id.* ¶ 22) and, notably, only one current member of the Audit and Examination Committee was even on the Board in 2007. (*See id.* ¶¶ 102-03.)

sector were terminated for improper sales practices." (*Id.* ¶ 28.) These allegations show at most that Wells Fargo's control functions detected and dealt with the problems Plaintiffs complain about – it is not evidence that the Board was aware that a significant problem existed that Wells Fargo's controls were not addressing.

Several of these accounts are taken from pleadings in five employment litigations by former employees alleging wrongful dismissal by the Company over the period from 2008 to 2013. (*See id.* ¶¶ 24-26, 33, 35, 212-19.) Courts routinely reject unproven allegations in other litigations as an adequate basis on which to state a claim even under less demanding pleading standards than the one Plaintiffs must meet. *Maine State Ret. Sys.* v. *Countrywide Fin. Corp.*, 2011 WL 4389689, at *21 (C.D. Cal. May 5, 2011) (striking allegations taken from other complaints "[b]ecause Plaintiffs have not reasonably investigated the allegations they copied from complaints in other cases"). Even meritorious allegations in a single lawsuit brought by a single employee – or even several employees – are highly unlikely ever to make their way to a single member of Wells Fargo's Board (Plaintiffs do not allege that any of the complaints that they reference did). This is easy to understand – Wells Fargo, like most large companies that are also large employers, is named as a defendant in thousands of lawsuits every year. If Wells Fargo's Directors undertook to read all of those complaints as they were filed, they would do nothing else.[11]

The Complaint goes on to allege that certain teams within the Company were charged with implementing "proactive monitoring of data analytics, specifically for the purpose of rooting out sales practice violations" and that those controls "identified simulated funding activity in the Los Angeles and Orange County markets, and [that the Company] terminated Wells Fargo employees for that conduct." (Compl. ¶ 27.) This allegation alone may be enough to require dismissal of the Complaint – it establishes that Wells Fargo implemented precisely those types of monitoring systems that Plaintiffs, if they are to be successful, must allege with particularity did not exist or were ignored. Here, the complaint alleges that Wells Fargo adopted systems and controls that succeeded in detecting

[11] Decl. Exhibit T is a table showing the results of a search in the PACER database of federal civil court cases for instances in which Wells Fargo was named as a defendant for the period 2013 to when the first derivative complaint was filed in federal court on September 29, 2016: more than 5,800 cases. If the Directors were to read one of these complaints – which do not include the thousands of lawsuits filed in state courts over the same period – every single day of the year, they would get through them all in 16 years.

wrongdoing, which wrongdoing was punished as severely as Wells Fargo could punish it. This is the opposite of a failure to monitor. *See*, *e.g.*, *South*, 62 A.3d at 18 ("These pled facts do not support an inference of an 'utter failure to attempt to assure a reasonable information and reporting system exists,' but rather the opposite: an evident effort to establish a reasonable system. . . . The complaint thus 'refutes the assertion that the directors' utterly failed to attempt to fulfill their oversight obligations.") (citing and quoting *Caremark*, 698 A.2d at 971, and *Stone*, 911 A.2d at 372). The fact that these systems were in place and that the Directors received "high-level" reports on ethics monitoring (Compl. ¶¶ 29, 209) suggests "an evident effort to establish a reasonable system," not the opposite.[12] Delaware courts have long recognized that "most of the decisions that a corporation, acting through its human agents, makes are, of course, not the subject of director attention." *Stone*, 911 A.2d at 372 (quoting *Caremark*, 698 A.2d at 968); *Impax Labs*, 2015 WL 5168777, at *7 (plaintiffs failed to plead demand futility because "the directors' good faith exercise of oversight responsibility may not invariably prevent employees from [causing harm to the corporation].") (quoting *Stone*, 911 A.2d at 373). A more appropriate inference is that the Board leaves individual ethics and related employment cases to management and counsel, who are equipped to handle those individual issues in a manner that the Board is not. The allegation that the Board knew of alleged "systemic" and extraordinary sales practice abuses based on these anecdotal reports is an unsupported conclusion.

C. News Media Reports Do Not Permit the Inference That There Was an Utter Failure of Oversight.

Plaintiffs' allegations concerning a December 2013 *L.A. Times* article on the sales practices in the Company's Community Banking division also do not support their allegations of scienter. *First*, as a factual matter, Plaintiffs' rendition of that article elides much that is pertinent to the demand-futility analysis. They allege that it "unquestionably alerted Defendants that those [improper sales] activities were pervasive and stemmed from the culture." (Compl. ¶ 40.) The article reports that Wells Fargo had previously dismissed 30-some employees and disciplined others for ethics violations in Southern

[12] The similar allegations that "the Board, from 2011 to 2013, would get reports at a Committee level, at a high-level about [EthicsLine requests], or information at not a granular but maybe at the company level" (Compl. ¶¶ 29, 209), and that the certain committees "received 'reports from management that it was monitoring sales integrity in Community Banking'" does not suggest a bad faith failure to monitor. (*Id.* ¶ 30.) Again, it shows the opposite. *See South*, 62 A.3d at 18.

California branches. (Decl. Ex. A.) To the extent there was a problem in that region, the article indicates that management had detected and had dealt with it in the most serious way that a company can discipline employees: dismissal.

Second, the *L.A. Times* article quotes a Wells Fargo spokesman who discussed the bank's "security procedures to root out employees who violate laws or bank ethics policy" because "[t]his is something [Wells Fargo] take[s] very seriously" and "[w]hen we find lapses, we do something about it, including firing people." (*Id.*) The article further reported that Wells Fargo, which had acquired Wachovia Bank during the financial crisis, was still dealing with integration issues among "80 lines of business," had undertaken a process to "ensure that its ethics policies are consistent" across those many business lines and had launched "an Ethics Program Office to review standards for employees and handling of conflicts of interest." (*Id.*) Plaintiffs plead no basis to disbelieve any of these assurances (having ignored them in describing the article). None of this suggests that Wells Fargo had no controls or that the Board knowingly failed to monitor the controls that it had – to the contrary, and once again, it suggests "an evident effort to establish a reasonable system." *South*, 62 A.3d at 18 (citing *Caremark*, 698 A.2d at 971).

D. Lawsuits Stemming from the *L.A. Times* Article Similarly Do Not Suggest an Utter Failure of Oversight.

Plaintiffs next allege that the Board was "confronted with additional red flags of misconduct when the L.A. City Attorney initiated a lawsuit" in May 2015, followed days later by a consumer class action in the Northern District. (Compl. ¶¶ 171, 174, 179.) The complaints initiating those suits alleged what Plaintiffs term "gaming" – several forms of alleged sales practice abuses. (*Id.*) Those complaints contain still more unproven allegations from other litigations that the Court should disregard for purposes of assessing whether Plaintiffs have met their pleading burden. *Maine State Ret. Sys.*, 2011 WL 4389689, at *21. The Complaint alleges that "[t]he Board was aware of the[se] litigations and investigations," though this appears to be based only upon Plaintiffs' allegation that "the Audit and Examination Committee and the Corporate Responsibility Committee were expressly responsible for tracking, overseeing, and addressing those proceedings and the issues from which they arose." (Compl. ¶ 186.) This is inadequate under Delaware law. "Mere membership on a committee or board, without specific allegations as to defendants' roles and conduct, is insufficient to support a

finding that directors were conflicted." *In re CNET Networks, Inc.*, 483 F. Supp. 2d 947, 963 (N.D. Cal. 2007) (citation omitted); *South*, 62 A.3d at 17 ("As numerous Delaware decisions make clear, an allegation that the underlying cause of a corporate trauma falls within the delegated authority of a board committee does not support an inference that the directors on that committee knew of and consciously disregarded the problem for purposes of Rule 23.1.").

But even if Plaintiffs had alleged that the Directors were aware of the L.A. City Attorney's lawsuit, they would have failed to plead that this indicates that they knowingly breached their oversight obligations. As the Complaint and the documents it references make clear, up to and including in 2015, Wells Fargo took numerous actions to address the issues described in the L.A. City Attorney complaint.[13] The unproven allegations of the L.A. City Attorney's complaint – were they provided to the Board – likely would have communicated only that these efforts were important and needed to continue. The Chancery Court's decision this past October in *Reiter* is instructive. That case involved derivative litigation brought against Capital One's directors concerning litigation and regulatory reviews alleging insufficient anti-money-laundering ("AML") controls at Capital One. *Reiter*, 2016 WL 6081823, at *13. Chancellor Bouchard analyzed similar claims as those alleged here and found them wanting:

> [T]he allegations of the Complaint and the documents incorporated therein would allow reasonable minds to argue either side of a debate over whether the directors' oversight of the Company's [AML] compliance program was sufficiently robust or flawed. But what those allegations do not reasonably permit [ ] is an inference that the defendants *consciously* allowed Capital One to violate the law so as to sustain a finding they acted in bad faith. As such, plaintiff has failed to plead with particularity that a majority of Capital One's ten-member board acted in such an egregious manner that they would face a substantial likelihood of liability for breaching their fiduciary duty of loyalty so as to disqualify them from applying disinterested and independent consideration to a stockholder demand.

Id. at 14 (emphasis in original).

E. Regulatory Investigations Do Not Demonstrate the Absence of Internal Controls.

Plaintiffs' next set of allegations is that regulators investigated sales practices issues at various times between 2012 and 2016. (Compl. ¶¶ 183-85, 220.) These allegations, like the others, do not

[13] (*See* Decl. Ex. E, at 5: "In 2013, [Wells Fargo] created a new corporate-wide enterprise oversight for sales practices. In 2014, [Wells Fargo] further revised [its] incentives compensation plans, to align pay with ethical performance. In 2015, [the Company] added more enhancements to [its] training materials, further lowered goals, and began a series of town hall meetings, to re-enforce the importance of ethical leadership[.]")

support an inference that the Board intentionally turned a blind eye to evidence of systemic control failures. Indeed, for most of these investigations, Plaintiffs provide no reason to believe that the Directors knew anything about them. For example, the first claim, that the OCC "received a small number of complaints from consumers and Bank employees" in 2012 (*id.* ¶ 183) does not indicate that anyone at Wells Fargo, let alone any Director, was made aware of this. The same is true for the allegation that "the CFPB reviewed whistleblower tips" in mid-2013. (*Id.* ¶ 184.) The allegation that FINRA assessed a $1.5 million penalty in December 2014 for "anti-money-laundering failures" related to broker-dealer accounts (*id.* ¶ 185) has nothing to do with the sales practices that form the basis for Plaintiffs' Complaint. The retail banking sales practices alleged in the Complaint nowhere allege anything about Wells Fargo's broker-dealer business, money laundering or Wells Fargo's anti-money-laundering controls. (*See id.* ¶¶ 184-85.) The FINRA settlement thus raised no red flags regarding sales practices issues at the Community Banking division. Plaintiffs also fail to allege that they were brought to the attention of any Director (Plaintiffs allege only that the Audit and Examination Committee *should have* received this correspondence). (*Id.* ¶¶ 187-88.)

F. OCC Examinations Do Not Demonstrate the Absence of Internal Controls.

The last genre of "red flags" allegedly known to the Board is correspondence from the OCC following its periodic examinations of Wells Fargo's subsidiary, Wells Fargo Bank, N.A. (Compl. ¶ 220, *et seq.*)[14] Once again, the Complaint nowhere alleges that the Board of Wells Fargo was ever made aware of any of these communications between the OCC and Wells Fargo Bank, other than to allege that "the Board would have known of the June 2015 Supervisory Letter, given its responsibility to 'ensure timely and effective correction of the practices described in the'" OCC-identified "matters requiring attention." (Compl. ¶ 228.) This is triply inadequate. *First*, it once again attempts to plead knowledge on the part of the Board based solely on Plaintiffs' assertions about what Plaintiffs believe the Board *should have* known. *Second*, Plaintiffs do not allege that the Supervisory Letter was directed to Wells Fargo, but to Wells Fargo Bank – the board that was obliged to ensure that the "matters

[14] Certain of these allegations, too, do not relate at all to sales practices. Plaintiffs' allegations concerning a consent order related to Bank Secrecy Act and AML compliance in the Wholesale Banking Group line of business (Compl. ¶ 231) have nothing to do with the sales practices in the Community Banking division at issue here. If anything, these allegations demonstrate that Wells Fargo's officers and Directors confront a wide range of serious and important issues – not just the reports and examinations regarding sales practices issues that Plaintiffs play up in their Complaint.

requiring attention" were resolved was that of the Bank, only seven of whose members were also members of the Wells Fargo Board (again, Plaintiffs need to plead the requisite knowledge on the part of eight Wells Fargo Directors). *Third*, even if the Wells Fargo Directors had been made aware of the June 2015 letter containing MRAs, that correspondence would not have communicated an utter lack of control systems. To be sure, the June 2015 correspondence called upon Wells Fargo Bank, N.A. to "re-evaluat[e] compensation and incentive plans" and "improv[e] processes." (Compl. ¶ 226.) But the instruction to "improve processes" presupposes processes.

That leaves just the July 18, 2016 Supervisory Letter (the contents of which Plaintiffs do not include in their allegations) and the September 1, 2016 Consent Order as potential "red flags," but Plaintiffs identify no failings by the Directors that occurred in the roughly six weeks between the July letter and this lawsuit. Indeed, Plaintiffs do not even allege that the Board actually received the July 2016 materials in advance of the Board's September 2016 meetings.

What can be gleaned from the Complaint about the Board's reaction to the OCC's supervisory actions appears perfectly appropriate: the Complaint alleges, if grudgingly, that the Company has followed through on actions ordered by the OCC and CFPB, which included a "Comprehensive Action Plan" to strengthen monitoring. (Compl. ¶¶ 423-24 (alleging that Wells Fargo changed its commission-based sales policy).) To the extent that this Comprehensive Action Plan involved or discussed the Board at all – Plaintiffs do not say – this evidences Board oversight, not a failure of oversight. Once again, "[t]hese pled facts do not support an inference of an 'utter failure to attempt to assure a reasonable information and reporting system exists,' but rather the opposite: an evident effort to establish a reasonable system." *South*, 62 A.3d 18 (citing and quoting *Caremark*, 698 A.2d at 971); *Reiter*, 2016 WL 6081823, at *13 ("the factual context here is fundamentally inconsistent with the inference plaintiff asks the Court to draw—that the directors must have known they were breaching their fiduciary duties by tolerating a climate in which the Company was operating part of its business in defiance of the law.").

Finally, what is perhaps most notable from a demand-futility perspective about the OCC examinations and correspondence and even the Consent Order is what they do not say. After all the examinations and investigations described in the Complaint, no regulator is alleged to have concluded,

or even said, anything concerning Wells Fargo's Directors. Had the Directors engaged in the sort of intentional mal- or nonfeasance that Plaintiffs are supposed to have alleged, one might expect a regulator to have noticed and to have said so. The Consent Order imposes obligations on Wells Fargo Bank to redress and remediate sales practices-related issues and anticipates that the *Wells Fargo Bank board will implement them* – again inconsistent with the Bank's primary regulator's having concluded that the Bank's board, let alone the Wells Fargo Board (the majority of whose members do not serve on the Bank's board), had proved incapable or unwilling to address them previously. (*See* Decl. Ex. D, at 3.)

* * *

In short, there is no allegation in the voluminous paragraphs cataloguing purported Board knowledge that pleads the "who, what, when, where and how" of any outside Director's knowledge of specific internal control failures and the Director's intentional intransigence in the face of that information. Plaintiffs have thus failed to do what Delaware law requires of them. *See In re Intel Corp. Deriv. Litig.*, 621 F. Supp. 2d 165, 175 (D. Del. 2009) (rejecting complaint that merely "catalog[s] the ongoing investigations into [ ] alleged wrongdoing, and then assert[s] that the thickness of the catalog demonstrates that [ ] conduct was so egregious and widespread that the Directors certainly must now face at least a 'substantial likelihood' of personal liability."); *Am. Apparel*, 2015 WL 12724070, at *2-4, 20, 26 (dismissing complaint that alleges numerous past employment litigations against a large company as insufficient to constitute red flags).

II. THE DIRECTORS DO NOT FACE A SUBSTANTIAL LIKELIHOOD OF LIABILITY FOR PLAINTIFFS' "PATTERN OF CONDUCT" AND INTENTIONAL MISREPRESENTATION CLAIMS.

Plaintiffs next attempt to allege a "pattern" of affirmative conduct that purportedly "show[s] a wholesale abandonment" of the Directors' fiduciary duties. (Compl. ¶¶ 479-80.) This includes (a) "allowing Wells Fargo insiders [ ] to engage in insider selling," (b) "causing Wells Fargo to file materially false and misleading SEC filings," and (c) "approving a share repurchase program through which Wells Fargo bought back millions of shares of stock at supposedly artificially inflated prices." (*Id.*) Each of these allegations of past misconduct is insufficiently pleaded as to the outside Directors and they fare no better when viewed as a "pattern."

First, Plaintiffs' failure to plead specific facts that establish the Board's knowledge of any

"scheme" is fatal to this claimed breach of duty. If the Directors did not know of a "scheme," then they necessarily did not know that Wells Fargo's disclosures were materially misleading because they did not mention any such "scheme." (*See* Compl. ¶¶ 382-94.) Similarly, while the Complaint lists the stock sales of four officers, it does not allege what the *Directors* knew about those sales.

Second, the outside Directors do not plausibly face liability for alleged misstatements in Wells Fargo's periodic SEC filings or other public disclosures. "[T]o establish a threat of director liability based on a disclosure violation, plaintiffs must plead facts that show that the violation was made knowingly or in bad faith, a showing that requires allegations regarding what the directors knew and when." *Citigroup*, 964 A.2d at 133-34. Plaintiffs challenge statements in Wells Fargo's 2014 to 2016 Proxy Statements "that failed to disclose the illicit account-creation scheme or the seriously deficient internal and disclosure controls[.]" (*See* Compl. ¶ 272-311.) Plaintiffs also allege that the Proxy Statements included passages discussing corporate governance, the Board's role in risk oversight, and the Bank's risk management and compensation practices. (*See*, *e.g.*, Compl. ¶¶ 276, 287, 299.) It is clear what about these latter statements Plaintiffs contend is false – they are sufficiently generic to describe virtually every banking institution's controls and any compensation system that rewards performance, as is usually considered desirable in a compensation system.

Even if Plaintiffs had pleaded a false statement, "the Complaint does not contain specific factual allegations that reasonably suggest sufficient board involvement in the preparation of the disclosures that would allow [the Court] to reasonably conclude that the director defendants face a substantial likelihood of personal liability." *Citigroup*, 964 A.2d at 134. The Complaint also "does not sufficiently allege that the director defendants had knowledge that any disclosures or omissions were false or misleading or that the director defendants acted in bad faith in not adequately informing themselves." *Id*.; *see Pirelli Armstrong Tire Corp. Retiree Med. Benef. Trust* v. *Lundgren*, 579 F. Supp. 2d 520, 532 (S.D.N.Y. 2008) (rejecting disclosure claim that did "not include particularized factual allegations indicating that any of these directors knew or should have known that any of the allegedly misleading statements were false or incomplete").

Third, Plaintiffs' allegations regarding Wells Fargo's repurchases of its own shares do not establish that the Directors face a "'substantial likelihood' of personal liability." The failure to plead

knowledge of the "sales-practices scheme" on the part of the Directors is fatal to any claim that these repurchases constituted breaches of their fiduciary duties. The allegation that the Directors face liability under the securities laws for those repurchases is risible. Plaintiffs' theory appears to be that Wells Fargo, acting through its officers and directors whose knowledge is attributable to Wells Fargo, made certain false statements that artificially inflated the price of Wells Fargo stock, and then Wells Fargo, acting again through the exact same officers and directors – and yet somehow unwittingly – bought its own stock at that inflated price. This claim is frivolous and self-contradictory. Wells Fargo could never plead or prove, as it would have to, that it had reasonably relied on either its own misstatements or on the market price that reflected those misstatements given that the knowledge of the people who allegedly knowingly made those misstatements *is Wells Fargo's knowledge*.[15] *See In re Verisign, Inc. Deriv. Litig.*, 531 F. Supp. 2d 1173, 1209 (N.D. Cal. 2007) ("Plaintiffs might be able to plead reliance if they were to allege that the corporate decision-maker for the repurchase of shares had no knowledge of the alleged fraud. Here, however, plaintiffs allege that all the senior management and board members not only knew about the alleged backdating but also caused it . . .").

Finally, to the extent that Plaintiffs allege intentional wrongdoing on the part of the Directors in relation to the cause of action for violation of California Corporations Code § 25403, that claim also fails. Plaintiffs allege that the Directors "through their positions, possessed control and influence over the Insider Selling Defendants' sale of Wells Fargo common stock in violation of the California Corporations Code." (Compl. ¶ 585.) It is not clear what this is supposed to mean (and it runs headlong into Plaintiffs' equally non-specific suggestions that the CEO somehow controlled the Board). (*See*, *e.g.*, Compl. ¶¶ 513-16.) What it cannot mean is that the Directors face a "'substantial likelihood' of personal liability" from these claims because Wells Fargo has no such claim – "no private right of action exists under Section 25403." *Apollo Capital Fund, LLC* v. *Roth Capital Partners, LLC*, 158 Cal. App. 4th 226, 255 (2007). This Section 25403 claim, which appears to have

[15] The 10b-5 claim further demonstrates the wisdom of Delaware's leaving decisions on litigation to the Board except in extraordinary circumstances. This claim is one only a plaintiffs' lawyer could love. Pursuing this claim would require the Company to prove that its own financial statements were misleading – not only to Wells Fargo, but to the world. In the course of pursuing claims against a few individuals who may or may not have the wherewithal to pay a judgment, Wells Fargo would have *confessed judgment* to everyone else who traded in Wells Fargo stock during the relevant period. No director in his or her right mind would condone the Company's pursuing such a claim. The fact that Plaintiffs have tried is a clear indication of where their interests actually lie.

been lifted from complaints filed in California Superior Court, was dropped by the state plaintiffs after Defendants informed them of this.[16]

III. PLAINTIFFS HAVE FAILED TO PLEAD THAT THE OUTSIDE DIRECTORS LACK INDEPENDENCE.

Plaintiffs allege that the five members of the Human Resources Committee lack independence because they were "responsible for administering and managing the Company's executive compensation program." (Compl. ¶ 513.) This allegation does not match any of the traditional notions of lack of independence, which are circumscribed to include only familial and similarly close relationships. *Beam* v. *Stewart*, 845 A.2d 1040, 1050 (Del. 2004) ("to render a director unable to consider demand, a relationship must be of a bias-producing nature. Allegations of mere personal friendship or a mere outside business relationship, standing alone, are insufficient to raise a reasonable doubt about a director's independence."). Indeed, Plaintiffs' allegations reverse the typical lack-of-independence showing. To be not independent of management, the Board would have to be beholden to management – because, say, management decided how much the Board members were paid (though that would only work in extreme circumstances and Plaintiffs nowhere allege that their Board compensation renders the Directors not independent).[17]

Plaintiffs' allegation is the opposite – that the Board is beholden to management *because the Board decides how much management is paid*. Nonsense. If what Plaintiffs actually intend to allege is

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[16] Each of Plaintiffs' other causes of action independently fails to plead specific facts necessary to create a substantial (or any) likelihood of Director liability. As to Count X (corporate waste), Plaintiffs come nowhere near pleading waste, which "is a rare 'unconscionable case[] where directors irrationally squander or give away corporate assets.'" *Disney,* 907 A.2d at 749 (quoting *Brehm*, 746 A.2d at 263). Count VII, which seeks injunctive relief or rescission of Defendants' contracts under Section 29(b) as a means to ensure that any clawback of compensation is unencumbered, is entirely derivative of the breach of duty and Securities Exchange Act claims – Directors face no independent liability pursuant to this cause of action. (Compl. ¶¶ 572-77 (seeking "injunctive relief barring Defendants from asserting breach of contract by Wells Fargo in any action by Plaintiffs on behalf of Wells Fargo to claw back compensation from Defendants."); *see also* 15 U.S.C. § 78cc(b) and 12 CFR § 218.780 (limiting Court's ability to void employment contracts).

[17] Nor could they. *See In re Walt Disney Co. Deriv. Litig.*, 731 A.2d 342, 354 n.18 (Del. Ch. 1998) (holding that directors' receipt of "director fees and stock options" is "insufficient to demonstrate any interest"), *rev'd in part on other grounds*, 746 A.2d 244. Allegations that "directors are paid for their services as directors . . . without more, do not establish any financial interest." *Grobow* v. *Perot*, 539 A.2d 180, 188 (Del. 1988), *overruled on other grounds,* 746 A.2d 244 (Del. 2000). Plaintiffs allege no particularized facts to displace "the general rule that demand is not excused simply because directors receive compensation from the company[.]" *Weiss* v. *Swanson*, 948 A.2d 433, 448 (Del. Ch. 2008).

that the Board *must be* beholden to management, otherwise why would the Directors have paid management so much, that is, at best, an (unreasonable) inference, not a fact. What are facts are that the members of management from whom the Directors are supposedly not independent, Tolstedt and Stumpf, no longer work at Wells Fargo and have forfeited $60 million of compensation that they otherwise would have received. Plaintiffs attempt to avoid these inconvenient facts by calling, for example, the $41 million in compensation that Stumpf forewent "a desperate attempt by Stumpf and the Board to deflect political pressure and submit a token offering to the Senate[.]" (*Id.* ¶ 516.) Calling an action that is obviously and indisputably *against* the interest of management "desperate" does not restore to Stumpf the $41 million that he was to earn but did not. Calling $41 million in foregone compensation a "token" is ludicrous.

There are numerous other facts that also demonstrate the Board's independence of management. The Directors formally separated the roles of the CEO and Board Chairman, adopting a bylaw requiring that the positions of Board Chairman and Vice Chairman always be held by independent Directors.[18] The Board has decided not to disperse bonuses to several former and current senior executives for 2016 and has terminated four Community Bank senior executives for cause. The Board has also announced that it will publicly disclose findings from its investigation in April 2017. None of this can be squared with the assertion (which Plaintiffs make improperly conclusorily in any event) that the Directors were beholden to Wells Fargo management.

CONCLUSION

For the foregoing reasons, the Court should grant Wells Fargo's motion to dismiss this action for failure to plead demand futility, with prejudice.

[18] Plaintiffs allege that the Board consistently recommended against shareholder votes to mandate separation of the CEO and chairperson roles. (Compl. ¶ 119.) This proposal by an individual shareholder to separate the roles allegedly dates back to 2005 (*id.*) – including times when Wells Fargo did not have an executive chairperson, demonstrating that the Board was in fact willing to operate under such a structure. (*Id.* ¶ 70 (no executive chairperson from 2007 to 2010)). Moreover, the shareholders voted the way they did and the fact that the Board counseled against this particular restriction cannot possibly evidence Director misconduct or lack of independence – about sales practices or anything else.

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Respectfully submitted,

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