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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 **PLAINTIFFS' OPPOSITION TO WELLS FARGO'S MOTION TO DISMISS THE CONSOLIDATED AMENDED VERIFIED STOCKHOLDER DERIVATIVE COMPLAINT FOR FAILURE TO ADEQUATELY PLEAD DEMAND FUTILITY** The Honorable Jon S. Tigar Hearing: May 4, 2017 at 9:30 a.m.

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Plaintiffs respectfully oppose Wells Fargo's motion to dismiss the Consolidated Amended Verified Stockholder Derivative Complaint ("Complaint") for failure to plead demand futility.[1]

PRELIMINARY STATEMENT

For nearly a decade, Wells Fargo's Board turned a blind eye to the creation of millions of fictitious customer accounts at the Company without those customers' knowledge or consent. The illicit account-creation scheme did not entail mere "sales-practices issues," as Defendants would have it (Defs.' Br. 1), but rather was "a staggering fraud." ¶ 7. The malfeasance allowed Wells Fargo to achieve "record" results in selling complementary banking products to prospective or existing customers, or "cross-selling," which Defendants touted as a "competitive advantage" for the Company and "key to [its] ability to grow revenue and earnings." ¶¶ 126, 135. The fallout from this scandal has been swift and severe, with Wells Fargo paying nearly $300 million in penalties and settlements (so far) and losing significant business.

Plaintiffs "offer a battery of particularized factual allegations that strongly support an inference at this stage of the litigation that the Board knew of and did nothing about illegal activity," rendering demand on the Directors futile. *Rosenbloom v. Pyott*, 765 F.3d 1137, 1152 (9th Cir. 2014). The Directors were confronted by numerous red flags, including: (1) warnings from Wells Fargo employees pointing to, among other things, "routine deception and fraudulent exploitation of [Wells Fargo's] clients," as of at least 2007; (2) litigation by former Wells Fargo employees relating to the unlawful creation of accounts; (3) reports received by the Board beginning in at least 2011 concerning improper sales practices; (4) multiple supervisory activities by the Office of the Comptroller of the Currency ("OCC") beginning in January 2012 and continuing to July 2016, as well as investigations by the U.S. Consumer Financial Protection Bureau ("CFPB") and the Financial Industry Regulatory Authority ("FINRA"); and (5) the termination of more than 5,300 employees, including 1,000 in 2011 alone, due to the illicit account-creation scheme. Notably, Wells Fargo's former CEO and Chairman Defendant John

[1] As the Individual Defendants have joined Wells Fargo's motion, Plaintiffs refer to this as "Defendants'" motion. Plaintiffs refer to the Director Defendants (identified in ¶¶ 76-90 of the Complaint) as the "Directors." All other capitalized terms are as defined in the Complaint. Finally, "¶ __" refers to paragraphs of the Complaint, and unless otherwise indicated, all emphasis has been added and all citations and internal quotation marks have been omitted.

Stumpf testified to the Senate Banking Committee that the Board "learned of" the unlawful sales practices "later [in] 2013 and then 2014 and on," and Wells Fargo stated to the Committee that several Board Committees received reports on "sales integrity" issues, which were discussed with the entire Board. ¶¶ 155-57, 258, 430.

On December 21, 2013, the red flags mounting from 2007 to 2013 were joined by a banner screaming "fraud": the *Los Angeles Times* published a detailed article, based on "a review of internal bank documents and court records, and from interviews with 28 former and seven current Wells Fargo employees who worked at bank branches in nine states," reporting that "[t]o meet quotas, employees have opened unneeded accounts for customers, ordered credit cards without customers' permission and forged client signatures on paperwork," with some employees "begg[ing] family members to open ghost accounts." ¶ 163. The Directors, who were informed of the article, could no longer ignore that Wells Fargo's drive for cross-selling success, combined with the gaping deficiencies in the Company's internal and disclosure controls, had created a culture fostering and *rewarding* unlawful sales practices. In contrast to the Board, the L.A. City Attorney embarked on a year-long investigation prompted by the *L.A. Times* report (leading to a lawsuit on behalf of the People of California in May 2015), which was joined by consumer class litigation as well as extensive OCC and CFPB investigations and subsequent regulatory actions.

In short, as U.S. Senators investigating the misconduct recently wrote, "top management and the board of directors of Wells Fargo knew or should have known about the extensive fraud occurring throughout the bank," and "Wells Fargo's internal review system was allowed to operate with serious flaws for years, remains flawed, and lacks appropriate controls to prevent future harm to the bank's customers." ¶ 49. To believe those numerous and glaring warnings went unnoticed by the Directors, as Defendants urge, is both illogical and unfaithful to the principle that at this stage the Court "must make reasonable inferences for Plaintiffs, not against them." *Rosenbloom*, 765 F.3d at 1153. Defendants' motion should be denied.

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STATEMENT OF FACTS

A. Cross-Selling Was Critical to Wells Fargo's Success, But Resulted in Unrelenting Pressure on Employees to Meet Strict Sales Quotas.

Cross-selling was the "foundation of [Wells Fargo's] business model and key to [its] ability to grow revenue and earnings." ¶ 126; *see also* ¶¶ 2-6, 123-40, 303, 327-68 (*e.g.*, ¶ 137 (Defendant Carrie Tolstedt, Senior Executive Vice President of Community Banking during the Relevant Period, stated "the cross-sell model . . . drive[s] revenue")). Defendants touted Wells Fargo's "legendary" cross-selling capability, and Stumpf highlighted the Company's longtime dedication to the strategy as a "competitive advantage." ¶¶ 127, 129-30, 136. Defendants implemented the strategy through their "Great Eight" or "Gr-Eight" initiative, striving for eight products per household. ¶¶ 2, 124-25, 130. And, in turn, the Company heralded its products-per-household metric as a barometer of its financial success, as it increasingly trended upward. ¶¶ 142-44. Wells Fargo reported, for example, its products per retail banking household grew from an average of 3.4 in 1999 to 5.92 in 2011, reaching a height of 6.17 in 2014. *Id.*

To achieve "record" cross-sell, Wells Fargo implemented strict quotas for the number of products its bankers were required to sell. ¶¶ 2, 124-25, 141-47, 163-67, 173-76, 327-67. Those quotas were set out in Wells Fargo documents, including the Store Manager Incentive Plan, which set forth the average number of "daily solutions" (i.e., products) bankers had to sell to meet their quotas, and were reviewed in regular meetings by district managers. ¶¶ 146-47. Employees who could not keep up with the sales-quota pace were told to "do whatever it takes" or face reprimand and eventual termination. ¶¶ 33, 174. Many who could not find customers willing to open accounts therefore resorted to opening fraudulent accounts to reach their quotas, often by manipulating or misrepresenting the Company's services to customers, referred to in the Incentive Plan as "gaming." ¶ 158. At the same time, Defendants represented that "the Company's corporate governance structure [wa]s working effectively as evidenced by the Company's strong financial performance." ¶¶ 111, 120. Indeed, the Board highlighted the purported strength of its corporate governance, including the Company's Corporate Governance Guidelines and Code of Ethics (both reviewed and adopted by the Governance and Nominating Committee), to urge

shareholders to reject a proposal for an independent chairman in the 2014, 2015, and 2016 Proxy Statements. ¶¶ 112-22.

B. Internal Complaints and Litigation by Wells Fargo Employees Alerted the Board to Unlawful Sales Practices.

Wells Fargo tracked employee complaints about illegal sales practices, which reached the Board. ¶¶ 158-59. At least as early as 2008, EthicsLine, the Company's confidential hotline to report suspected ethical or business violations, began monitoring issues related to "gaming" or "sales incentives" violations driven by sales pressure. ¶¶ 158-59. Those complaints were then reported to various Board Committees, including the Audit and Examination Committee and the Risk Committee, that were tasked with overseeing information about ethics violations and "noteworthy risk issues [including] sales conduct and practice issues." ¶¶ 152-56, 209-10. Further, beginning in at least 2007, internal complaints were sent to EthicsLine, Human Resources, and Stumpf, several of which were directed to the Board at BoardCommunications@wellsfargo.com or via Board Committees. ¶¶ 24-26, 33, 35, 196-210.

In September 2007, the Audit and Examination Committee and Stumpf received letters from an employee discussing how the Gr-Eight Initiative created a high-pressure sales culture that resulted in "unethical and illegal activity," including "routine deception and fraudulent exploitation of [Wells Fargo's] clients," which was conducted "for the sole and singular purpose of acquiring sales and bonus compensation" and was "widespread and so highly encouraged that it ha[d] become a normal sales practice." ¶¶ 22, 211, 484. That same employee later won a whistleblower lawsuit in 2008 against Wells Fargo related to his reporting of the creation of fake brokerage accounts. ¶ 212.

In separate 2011 incidents, branch managers from New Jersey and Arizona emailed Stumpf and several HR executives, warning that employees were creating fake accounts to reach sales quotas. ¶¶ 28, 200-03. Beginning in 2011, the Audit and Examination Committee received reports on "sales integrity" issues, and the Risk Committee and Human Resources Committee subsequently received similar reports. ¶¶ 155, 209, 260-61. Those reports were discussed with the full Board. ¶¶ 209, 261. The Board also learned "sometime in 2013" that Wells Fargo's

regulators were informed of the growing problem with sales practices, including fraudulent account openings. ¶ 258. Stumpf has testified he "learn[ed] of an increase in the number of reports of sales-practice issues in late 2013" (¶¶ 157, 210), the same year the *L.A. Times* reported on the connection between improper sales practices and the Company's relentless pressure to achieve record cross-sell (¶ 163). On April 3, 2015, a former Wells Fargo banker in California mailed and emailed a letter to both Stumpf and the Board advising them of "unethical practices in sales due to the continuous management threat of negative consequences if they did not produce 'solutions,'" and later forwarded to the Board an email from a California branch manager explaining employees had "a mandatory goal of 15 [solutions] by the end of the day." ¶¶ 205-07.

From at least 2011 until September 2016, more than 5,300 Wells Fargo employees from branches across the country—including 1,000 in 2011 (the first year of the Relevant Period) alone—were terminated specifically for sales-practice violations. ¶¶ 246-47. The Company also faced a series of lawsuits by former employees alleging improper sales practices that spanned several years and related to branches around the country. ¶¶ 25-26, 213-19.

C. Detailed Reports in the Press Alerted the Board to Unlawful Sales Practices.

In December 2013, the *L.A. Times* dropped a bombshell: a detailed report exposing the effect Wells Fargo's relentless focus on cross-selling and strict sales quotas had on its bankers and, in turn, its customers. ¶¶ 37, 163-67. Based on "a review of internal bank documents and court records, and from interviews with 28 former and seven current Wells Fargo employees who worked at bank branches in nine states," the article recounted the "relentless pressure to sell" that forced employees to open unneeded and unauthorized accounts for customers, order credit cards without customer permission, forge customer signatures on paperwork, and beg family members to allow them to open "ghost" accounts to meet sales quotas. *Id.* It also reported Wells Fargo managers "coached workers on how to inflate sales numbers." ¶ 164. Stumpf has admitted he learned of the *L.A. Times* article around the time it was published, and *discussed it with the Board*. ¶¶ 40, 169. Defendant Timothy Sloan, then-CFO of Wells Fargo (now its CEO), was made aware of the article's contents even before it was published. ¶ 168. The Board nonetheless failed to meaningfully address the unlawful practices detailed in the report as well as the deficient

internal and disclosure controls that enabled them. ¶¶ 15, 47-48, 220-38, 258-62.

D. Regulators and Others Alerted the Board to Unlawful Sales Practices.

Unlike the Directors, regulators and others were spurred to action by the revelations in the *L.A. Times* report. After reading the article, L.A. City Attorney Michael Feuer directed his staff to investigate Wells Fargo's sales practices. ¶ 172. After a year and a half of "good old-fashioned detective work," including witness interviews with employees and consumers, as well as a review of consumer-complaint databases and public court records, Feuer filed a civil enforcement action in May 2015 seeking relief for consumers and an end to the illegal sales practices. ¶¶ 172-73. The complaint described several of the same practices identified in the *L.A. Times* article. ¶ 174. The complaint also alleged senior Wells Fargo managers and other personnel were aware of—and condoned—those tactics, directed at generating additional "solutions" that would count toward sales quotas. ¶¶ 175-76. Later that month, consumers filed a class action against Wells Fargo based on the same misconduct. ¶¶ 179-82.[2]

Ongoing investigations of Wells Fargo Bank (on whose board seven of the Directors served, *see* Cullen Decl. Ex. D) by the OCC between January 2012 and July 2016 further warned the Directors of the Company's heightened risk exposure due to its sales practices. ¶¶ 31-32, 220-38. Those examinations included Supervisory Letters and Matters Requiring Attention, or "MRAs," which identified weaknesses in the Bank's compliance, risk, and other corporate-governance functions as well as programs "related to unfair and deceptive practices." ¶¶ 221-23. In early 2014, the OCC directed the Bank to address weaknesses in compliance risk, noting *the need to assess cross-selling and sales practices* as part of the OCC's upcoming examination of governance practices. ¶ 222. The OCC issued a Supervisory Letter in April 2015, including an MRA directing the Bank to address the governance of sales practices within its Community Banking division—the very activities at issue in this Complaint. ¶ 223. The OCC issued an additional Supervisory Letter in June 2015, again identifying issues and corrective action needed with respect to oversight of the Bank's sales practices; the Supervisory Letter included five

[2] On March 28, 2017, Wells Fargo announced it had agreed to settle the class action for $110 million. *Jabbari v. Wells Fargo, N.A., et al.*, Case No. 15-cv-02159-VC (N.D. Cal.), Dkt. 96.

MRAs, including several items specifically related to sales-practice risk and Wells Fargo's sales-incentive programs, which the OCC identified could lead to improper sales activities. ¶ 226. OCC Bulletin 2014-52 states the OCC "expects the bank's board of directors to ensure timely and effective correction of the practices described in an MRA." ¶ 228. The OCC continued investigating throughout 2015 and 2016, including issuing Reports of Examination and Supervisory Letters as well as directing independent consultants to conduct a review of the Bank's sales practices and assess consumer harm. ¶¶ 229-37. The OCC's investigation led to a series of three quarterly findings by independent consultants between October 2015 and May 2016, which also identified deficiencies in the Bank's internal controls and compliance functions. ¶¶ 230-32. In July 2016, the OCC issued its Report of Examination, finding the Bank's sales practices were unethical and caused harm to consumers. ¶ 234. On July 18, 2016, the OCC sent a Supervisory Letter to Stumpf concluding the Bank engaged in what OCC Comptroller Thomas Curry described as "unsafe or unsound banking practices." ¶ 235.[3]

Additionally, "in consultation . . . with regulators and the [L.A.] city attorney's office," Wells Fargo engaged Pricewaterhouse Coopers ("PwC") in August 2015 to determine "who may have suffered financial harm as a result of an account that may not have been authorized, and to quantify what that financial harm might have been"; the inquiry did not include assessing why the illicit account-creation scheme had occurred or how to stop it. ¶¶ 254-57. After investigating accounts opened between 2011 and 2015, PwC reported over two million deposit and consumer credit card accounts may have been unauthorized, resulting in $2.6 million in improper fees. ¶ 255. The Company did not publicly disclose PwC's findings or the scope and duration of the fraud until after announcing settlements with regulators and the L.A. City Attorney in September 2016. ¶¶ 257, 413.

On September 8, 2016, Wells Fargo announced it was settling the L.A. City Attorney's lawsuit and entering into consent orders with the OCC and CFPB; in addition to paying fines

[3] In December 2014, the Board was further notified of deficiencies in its corporate-governance procedures when FINRA issued a fine against Wells Fargo for anti-money-laundering failures in not verifying the identity of each customer opening a new account; FINRA identified 220,000 new customer accounts for which the Company had not properly verified identification. ¶ 185.

totaling $185 million, the Company agreed to provide restitution to any customer who suffered a direct monetary loss in connection with an unauthorized account. ¶¶ 412, 414-25. Significant ongoing and additional harm to Wells Fargo's business and reputation as a result of the illicit account-creation scheme continues to damage the Company and its shareholders. ¶¶ 444-74.

ARGUMENT

I. PLAINTIFFS ARE ENTITLED TO ALL REASONABLE INFERENCES ARISING FROM THEIR PARTICULARIZED ALLEGATIONS, WHICH MUST BE ASSESSED COLLECTIVELY

On this pre-discovery motion to dismiss, Plaintiffs "need not plead particularized facts sufficient to sustain a 'judicial finding' either of director interest or lack of director independence or of another disabling factor," and they "need not plead evidence." *In re EZCORP Inc. Consulting Agreement Derivative Litig.*, No. 9962-VCL, 2016 WL 301245, at *33 (Del. Ch. Jan. 25, 2016). The particularity requirement, moreover, "does not entitle a court to discredit or weigh the persuasiveness of well-pled allegations." *La. Mun. Police Emps.' Ret. Sys. v. Pyott*, 46 A.3d 313, 351 (Del. Ch. 2012) ("*LAMPERS*"), *rev'd on other grounds*, 74 A.3d 612 (Del. 2013). Further, "it is important that the trial court consider all the particularized facts pled by the plaintiffs . . . in their totality and not in isolation from each other, and draw all reasonable inferences from the totality of those facts in favor of the plaintiffs." *Del. Cnty. Emps. Ret. Fund v. Sanchez*, 124 A.3d 1017, 1019 (Del. 2015).

Demand is futile when particularized allegations "create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand." *EZCORP*, 2016 WL 301245, at *33. "Reasonable doubt" in this context is "akin to the concept that the stockholder has *a reasonable belief* that the board lacks independence or that the transaction was not protected by the business judgment rule"—an "objective test." *Id.* Where, as here, a majority—indeed, all—of the Directors "would face a substantial risk of liability if the litigation were pursued," demand is excused. *LAMPERS*, 46 A.3d at 351. To plead a substantial risk of liability, Plaintiffs "do[] not have to demonstrate a reasonable probability of success on the claim." *Id.* Rather, they "need only 'make a threshold showing, through the allegation of particularized facts, that their claims

have some merit.'" *Id.* (quoting *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993)).

Defendants' motion flouts each of the above principles. Specifically, Defendants ask the Court to (1) ignore whole swaths of Plaintiffs' allegations; (2) consider, for their truth, facts beyond the Complaint; (3) afford *Defendants* the benefit of inferences from Plaintiffs' allegations; and (4) evaluate the allegations individually rather than holistically. Defendants' attempt to turn the pleading standard on its head must be rejected.

II. THE DIRECTORS FACE A SUBSTANTIAL RISK OF LIABILITY AS TO PLAINTIFFS' CLAIMS

A. Plaintiffs Sufficiently Allege the Directors' Conscious Disregard of the Pervasive Fraud at Wells Fargo.

A director "cannot be loyal to a Delaware corporation by knowingly causing it to seek profit by violating the law." *In re Massey Energy Co. Derivative & Class Action Litig.*, No. 5430-VCS, 2011 WL 2176479, at *20 (Del. Ch. May 31, 2011). Nor does the business judgment rule countenance such misconduct. *In re Duke Energy Corp. Derivative Litig.*, No. 7705-VCG, 2016 WL 4543788, at *15 (Del. Ch. Aug. 31, 2016). Conscious disregard of wrongdoing also violates Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and SEC Rule 10b-5. *See In re Countrywide Fin. Corp. Derivative Litig.*, 554 F. Supp. 2d 1044, 1082 (C.D. Cal. 2008) ("For the same reasons that it found a strong inference of scienter [as to 10b-5 claims], the Court finds that the Complaint pleads evidence of a 'sustained or systematic failure of the board to exercise oversight,' so as to create a substantial likelihood of liability for at least the members of [the Audit & Ethics and Finance] Committees.").

Defendants characterize the fiduciary-duty allegations against the Directors as comprising a "*Caremark* 'failure to monitor' claim." Defs.' Br. 1 (quoting *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996)). But while Plaintiffs' allegations "that the Board knew or should have known about illegal conduct and made a conscious choice to turn a blind eye" can be evaluated "either as a *Caremark*-type oversight claim or as an *Aronson* [i.e., *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984)] type allegation of considered board action," this Court "need not decide which characterization of Plaintiffs' allegations is correct because, either way, demand is excused if Plaintiffs' particularized allegations create a reasonable doubt as to

whether a majority of the [Wells Fargo] board faces a substantial likelihood of liability for failing to act in the face of a known duty to act." *Rosenbloom*, 765 F.3d at 1150-51. Because the Directors "had actual or constructive knowledge of violations of the law at [Wells Fargo]" involving the illicit creation of accounts "and did nothing," the Board "violated its duty of loyalty and faces a substantial likelihood of liability." *Id.* Plaintiffs' allegations, in other words, afford "an *inference* of conscious inaction"—all that is required. *Id.* at 1156 (emphasis in original).

That inference is strengthened by the nature of the conduct the Directors are alleged to have consciously disregarded: As Senator Pat Toomey (R-PA) aptly summarized, "Failing to notify these customers about these sham accounts . . . is fraud." ¶ 6. Contrary to Defendants' attempt now to portray the wrongdoing as the sporadic actions of a few rogue employees, the years-long scheme involved thousands of employees in branches across the country and pervaded Wells Fargo's Community Banking division, which accounted for significantly more revenue than either of the Company's other two reportable operating segments. ¶¶ 69, 151-252. As CFPB Director Richard Cordray put it in announcing the Bureau's record $100 million settlement with Wells Fargo: "The gravity and breadth of the fraud that occurred at Wells Fargo cannot be pushed aside as the stray misconduct of just a few bad apples"; rather, "the stunning nature and scale of these practices reflects instead the consequences of a diseased orchard." ¶ 20; *see also* ¶ 421. Plaintiffs thus do not seek merely to "impos[e] *Caremark*-type duties on [the] [D]irectors to monitor business risk"; the claims here are "fundamentally different" in that they involve the Directors' "duty to monitor fraud and illegal activity." *LAMPERS*, 46 A.3d at 352.

The inference of the Directors' conscious disregard of the illicit account-creation scheme is further bolstered by Defendants' own representations touting the Company's oversight functions and internal controls, including the Board's critical role in ensuring those processes were sufficient. ¶¶ 110-22, 153, 238-43, 264, 274-311, 369-77. Each Board Committee "is responsible for oversight of specific risks, including reputation risks," and the Board and its Committees "work closely with management in overseeing risk," including through regular reports from management. ¶ 370. The Audit and Examination Committee, for example, is charged with assisting in the Board's oversight of "the integrity of the Company's financial

statements and the adequacy and reliability of disclosures to stockholders, including management activities related to accounting and financial reporting and internal controls," as well as overseeing "the Company's compliance with legal and regulatory requirements, financial crimes risk . . . and reputation risk related to the Committee's responsibilities." ¶ 103; *see also* ¶ 104. The Risk Committee "serves as a focal point for enterprise-wide risk issues, overseeing all key risks facing the Company," and the Corporate Responsibility Committee is charged with "review[ing] and approv[ing], and recommend[ing] to the Risk Committee for its approval, the Company's reputation risk management framework, which outlines the Company's governance framework and approach for managing and monitoring reputation risk." ¶¶ 106, 109. Wells Fargo has admitted to the Senate Banking Committee that from at least 2011, the Audit and Examination Committee received periodic reports from the Company's Internal Investigations group, as well as EthicsLine reports, showing "increase in sales integrity issues." ¶¶ 30, 209, 261. The Risk and Human Resources Committees also received reports relating to sales conduct. ¶¶ 30, 261. Wells Fargo has further acknowledged, "Sales integrity issues were also discussed periodically with the Board." ¶¶ 157, 261.

Defendants' representations concerning the Board's involvement in risk management, in addition to the Company's statements to Congress, strongly support an inference that the Directors knew about the illicit account-creation scheme as it was happening and failed to adequately address it at that time. *See Countrywide*, 554 F. Supp. 2d at 1081-82 (where "several of the Board's Committees were directly responsible for monitoring Countrywide's risk exposures and the financial performance of its loan portfolio," it "defie[d] reason, given the entirety of the allegations, that these Committee members could be blind to widespread deviations from the underwriting policies and standards being committed by employees at all levels"). This reasonable inference is not, moreover, akin to inferring knowledge based solely on "'mere membership on a committee or board,'" as Defendants contend.[4] The inference is particularly

[4] *Compare* Defs.' Br. 15-16 (quoting *In re CNET Networks, Inc.*, 483 F. Supp. 2d 947, 963 (N.D. Cal. 2007)) with *In re Biopure Corp. Derivative Litig.*, 424 F. Supp. 2d 305, 307-08 (D. Mass. 2006) ("Though caselaw is clear that a defendant's corporate position alone cannot support an allegation of that defendant's scienter, in cases in which a company's primary product or service is in jeopardy, courts have been willing to impute that knowledge to the company's officers and

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reasonable given Plaintiffs' detailed allegations of numerous red flags directly relating to the same activities lying at the core of this case (*see* ¶¶ 151-252), including Stumpf's admission that the Board received reports regarding sales practices and was aware *as of 2013* about the unlawful creation of accounts. ¶¶ 154-57, 209-10, 258-62. Defendants' preferred inference—"that Wells Fargo's control functions detected and dealt with the problems Plaintiffs complain about" (Defs.' Br. 13)—is belied by Plaintiffs' allegations and improper on this motion (*supra* pp. 8-9).

Further, while Wells Fargo's brief *nowhere* mentions cross-selling, it was (as Defendants repeatedly emphasized during the Relevant Period) central to the Company's brand, financial condition, and prospects. ¶¶ 124-40; *supra* pp. 3-4. The critical importance of cross-selling to Wells Fargo supports the reasonable inference that the Directors were aware of material information relating to the Company's cross-selling efforts, including information concerning the unlawful creation of accounts. "In demand futility cases, courts have repeatedly emphasized that it is especially plausible to infer board interest in and knowledge of developments relating to a product that is critical to a company's success or is otherwise of special importance to it." *Rosenbloom*, 765 F.3d at 1154 (citing cases). The Ninth Circuit in *Rosenbloom* thus held plaintiffs sufficiently pleaded demand futility given that, among other things, "the illegal conduct . . . involved one of the most important drugs at Allergan." *Id.* So too, here.[5]

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directors.") (citing cases). Plaintiffs' allegations are far stronger than those in *CNET*, an options-backdating case on which Defendants rely, where plaintiffs "merely alleg[ed] that [the directors] ratified the [options] grants as board members, without more." 483 F. Supp. 2d at 965.

[5] Plaintiffs also allege Defendants Chen, Dean, Engel, James, and Sanger—members of the Board's Human Resources Committee who were responsible for approving executive compensation—failed to exercise business judgment and demonstrated a lack of independence and disinterestedness. ¶¶ 492, 494-97. Those directors were charged with overseeing "the implementation of risk-balancing and risk management methodologies for incentive compensation plans and programs for senior executives . . . in a position to expose the Company to material risk." ¶ 107. Those Defendants failed to address and limit risk associated with Wells Fargo's cross-selling culture, and repeatedly approved the compensation scheme that rewarded Defendants Stumpf, Sloan, Tolstedt, and Shrewsberry "for success in achieving strategic objectives . . . including success in furthering the Company's objectives of cross-selling products" (¶¶ 514-17), notwithstanding the pervasive fraud at the Company. Defendants' mischaracterizations of Plaintiffs' allegations, as well as their cramped reading (at 22) of "traditional notions of lack of independence," are unavailing.

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B. The Directors Face a Substantial Risk of Liability for Making False or Misleading Statements to Shareholders.

Plaintiffs also allege the Directors made false or misleading statements of material fact (i) in Proxy Statements recommending that shareholders vote against a proposal to separate the chairman and CEO positions, to reelect the Directors, and to approve executive compensation; and (ii) in SEC Form 10-Ks signed by the Directors. By failing to disclose the illicit account-creation scheme and Wells Fargo's deficient controls that enabled and helped perpetuate it, the Directors violated their fiduciary duty of loyalty as well as Section 14(a) of the Exchange Act.

1. The Directors breached their fiduciary duty by failing to disclose material information within their control.

"Fiduciary duty requires honesty from corporate directors in their communications with the public and shareholders about corporate matters." *Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust v. Stumpf*, No. C 11-2369 SI, 2012 WL 424557, at *6 (N.D. Cal. Feb. 9, 2012). Where, as here, "defendants did not disclose material information within the Board's control" when seeking shareholder action through proxy statements, they "breached their duty of loyalty to the Company." *Id.* at *7. Likewise, "[w]hen the directors disseminate information to stockholders when no stockholder action is sought, the fiduciary duties of care, loyalty, and good faith apply," and "[d]issemination of false information could violate one or more of those duties." *Malone v. Brincat*, 722 A.2d 5, 12 (Del. 1998). The Directors face a substantial risk of liability with respect to their statements to shareholders during the Relevant Period.

Despite the array of information alerting them to a pervasive scheme to unlawfully create accounts without customers' knowledge or consent, the Directors signed SEC Form 10-Ks and issued Proxy Statements that failed to disclose that Wells Fargo's purported success in cross-selling was due in material part to the illicit account-creation scheme. ¶¶ 273-311, 333, 344, 358, 367, 370, 374, 377, 379. Those filings (including documents incorporated by reference in them) attested to the purported robustness of the Company's internal and disclosure controls and its risk-management processes—representations that were, in light of the facts detailed above, false or misleading when made. ¶¶ 112-22, 273-311, 327-81. Further, it cannot be said on this motion—and indeed, Defendants do not appear to argue—that Plaintiffs fail to plead materiality,

i.e., "a substantial likelihood that the disclosure of the omitted facts" concerning the illicit account-creation scheme "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Gantler v. Stephens*, 965 A.2d 695, 710 (Del. 2009).[6] The Directors face a substantial risk of liability for breaching their fiduciary duty of loyalty by making materially false or misleading statements to shareholders.

In the derivative litigation arising from Wells Fargo's policy of "mass processing the declarations or affidavits to be submitted in court proceedings to accelerate [home foreclosure] proceedings," or "robo-signing," Judge Illston held plaintiffs sufficiently pleaded demand futility against the Wells Fargo board—which at the time consisted of 11 of the 15 Directors named here[7]—based on alleged false or misleading statements in a proxy statement. *Stumpf*, 2012 WL 424557, at *1, *5-7. Plaintiffs there alleged all the board members breached their fiduciary duty of loyalty by advising shareholders to vote against a proposal to undertake an internal investigation into the alleged robo-signing, while omitting material information regarding the proposal. *Id.* at *6. While the directors represented to shareholders that Wells Fargo had initiated "self-assessments" and that a new investigation "could distract" from the Company's cooperation with regulator reviews, the Company was allegedly "mounting an immense pushback against those very reviews." *Id.* Before the proxy statement was issued, Stumpf and former CFO Howard Atkins "assured investors that the signer and reviewer of the affidavits were one and the same," despite several media reports of trial and deposition testimony "reveal[ing] that several Wells Fargo Vice Presidents were signing affidavits while only verifying their dates, not the underlying information." *Id.*

As here, the directors in the robo-signing case contended demand was not excused because "[n]owhere [wa]s there a *single particularized fact* about how any Director was involved in the use of affidavits in foreclosures, how he or she personally benefitted from them, or why he

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[6] To prevail on a fiduciary-duty claim arising from disclosure violations in connection with a request for stockholder action, plaintiff must show only that the challenged disclosure "ha[s] a connection to the request for shareholder action," which turns primarily on "whether the alleged omission or misrepresentation is material." *Malone*, 722 A.2d at 12.

[7] Defendants Stumpf, Baker, Chen, Dean, Engel, Hernandez, James, Milligan, Runstad, Sanger, and Swenson were also defendants in that action.

or she could not independently evaluate a demand." *Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust v. Stumpf*, No. 11-cv-2369-SI (N.D. Cal. filed Oct. 5, 2011), Dkt. 65, at 9 (emphasis in original); *see also* Defs.' Br. 5 (arguing Plaintiffs "never set forth with specificity how any Director personally came to know about the alleged 'scheme'"). But the court held plaintiffs sufficiently alleged defendants breached their fiduciary duty of loyalty "by failing to disclose that, in the course of government investigations, Wells Fargo had opposed discovery requests, filed motions to quash, and refused to provide details concerning the Company's policies." *Stumpf*, 2012 WL 424557, at *7. The pervasive fraud giving rise to this case is even more egregious than the alleged robo-signing practices. The Court reasonably can infer the Directors' representations through the Company's Form 10-Ks and Proxy Statements were false or misleading given that they consciously disregarded the illicit account-creation scheme.

Plaintiffs' allegations are also far more particularized and compelling than those deemed deficient in *In re Citigroup Inc. Shareholder Derivative Litigation*, on which Defendants rely. The *Citigroup* complaint "merely allege[d], in general and conclusory terms, that the director defendants did not adequately disclose certain risks faced by the Company." 964 A.2d 106, 133 (Del. Ch. 2009). Further, plaintiffs failed to "allege facts suggesting that the director defendants prepared the financial statements or that they were directly responsible for the misstatements or omissions." *Id.* at 134. Conversely here, the Directors *signed* false or misleading Form 10-Ks and issued false or misleading Proxy Statements. ¶¶ 273-311, 333, 344, 358, 367, 370, 374, 377, 379 (*e.g.*, ¶ 367 (identifying Form 10-K(s) signed by each Director)). The Directors' assertion that they cannot be held accountable for material omissions from documents they attested to on behalf of the Company is remarkable, and contrary to law. *See supra* pp. 13-14. Finally, plaintiffs in *Citigroup* alleged director knowledge based on "nothing more than indications of worsening economic conditions." *Id.* Not so, here.[8]

[8] Nor do Defendants' other cases assist them. Plaintiffs in *In re American Apparel, Inc. 2014 Derivative Shareholder Litigation*, for example, alleged the directors failed to disclose "sexual harassment and other violations of law" by the CEO. No. CV-14-05230-MWF (JEMx), 2015 WL 12724070, at *2 (C.D. Cal. Apr. 28, 2015). In dismissing the case, the court held, among other things, plaintiffs "fail[ed] to articulate how the Director Defendants"—who fired the CEO—"demonstrated a conscious disregard for their responsibilities when, *as Plaintiffs concede*, they did take action for precisely the reasons Plaintiffs assert they should have." *Id.* at *17. *American*

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2. The Directors are also subject to liability under Section 14(a) for disseminating materially false or misleading Proxy Statements.

Section 14(a) of the Exchange Act, through SEC Rule 14a-9, prohibits the making of false or misleading statements of fact in proxy statements. The statute requires only *negligence*, not knowledge or conscious disregard of misconduct. *In re Maxim Integrated Prods., Inc., Derivative Litig.*, 574 F. Supp. 2d 1046, 1066 (N.D. Cal. 2008).[9] The Complaint easily meets this standard, alleging the Directors negligently caused the issuance of materially misleading statements in the 2014, 2015, and 2016 Proxy Statements. ¶¶ 273-311.

The Proxy Statements contained proposals to Wells Fargo's stockholders urging them to re-elect Board members, approve executive compensation, and vote against stockholder proposals for the Company to adopt a policy requiring an independent Board chairman. *Id.* They also highlighted Wells Fargo financial metrics Plaintiffs allege were false or misleading due to the illicit account-creation scheme—including in recommending approval of Defendant Carrie Tolstedt's compensation based on the Community Banking division's "record cross-sell and deposit levels." ¶¶ 116-22, 273-311. The Proxy Statements failed to disclose numerous material facts, including: (i) deficiencies in Wells Fargo's internal and disclosure controls; (ii) the fact that Wells Fargo employees unlawfully opened accounts on behalf of customers for years, as well as the corresponding impact of those unlawful sales practices in artificially inflating the Company's cross-selling metrics and other financial results; (iii) Defendants' failure to meaningfully address the illicit account-creation scheme; and (iv) pending governmental investigations into the scheme and Wells Fargo's inadequate controls. ¶¶ 124-45, 151-78, 183-271. In short, "the essence of

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Apparel bears no resemblance to this case. And plaintiffs in *Pirelli Armstrong Tire Corp. Retiree Medical Benefits Trust v. Lundgren* "allege[d] that [the] Audit Committee had special access to financial information and responsibility for financial statements and guidance, but fail[ed] to allege, except in a conclusory manner, any adverse non-public information of which directors on this committee would have become aware." 579 F. Supp. 2d 520, 534 (S.D.N.Y. 2008). The conclusory allegations in Defendants' cases are a world apart from Plaintiffs' particularized allegations detailing the "staggering fraud" at Wells Fargo.

[9] Even were the Court to determine this claim "sounds in fraud," Plaintiffs must still only plead negligence (supported by particularized facts). *In re Zoran Corp. Derivative Litig.*, 511 F. Supp. 2d 986, 1015 (N.D. Cal. 2007). Nor does Wells Fargo's exculpatory clause encompass this claim. *See* Cullen Decl. (Dkt. 99-1) Ex. P at 7 (exculpating directors for certain claims "for breach of fiduciary duty"). In any event, as detailed above, Plaintiffs sufficiently plead the Directors' conscious disregard of misconduct, thus satisfying even a scienter-based standard.

Plaintiffs' proxy-related allegation is the failure to disclose the true operational and financial state of [Wells Fargo] to shareholders"—a viable theory of liability. *Countrywide*, 554 F. Supp. 2d at 1075. Further, Plaintiffs sufficiently allege the Proxy Statements were "an essential link" in shareholders reelecting the Directors, approving executive compensation, and defeating a proposal to separate the positions of chairman and CEO. *See Zoran*, 511 F. Supp. 2d at 1016 (plaintiff "must show that 'the proxy solicitation itself, rather than the particular defect in the materials, was an essential link in the accomplishment of the transaction'") (quoting *Mills v. Elec. Auto–Lite Co.*, 396 U.S. 375, 385 (1970)). By repeatedly failing to disclose the illicit account-creation scheme and the related deficiencies in Wells Fargo's internal and disclosure controls, the Directors "used the proxy solicitations to maintain their positions on [Wells Fargo]'s board." *Id.* Shareholders, meanwhile, "kept voting for the board members in blissful ignorance of the scheme." *Id.* Had shareholders known of the widespread and persistent misconduct, as well as the extent to which Wells Fargo's financial results were attributable to unlawful sales practices, "this likely would have changed their votes." *Id.*; *see also Countrywide*, 554 F. Supp. 2d at 1077 ("Shareholders would reasonably consider the Company's financial performance in deciding whether to reelect the directors."). The Directors accordingly face a substantial risk of liability on Plaintiffs' Section 14(a) claim, rendering demand futile.[10]

C. Defendants' Repeated Attempts to Invert the Principles Governing This Motion Should Be Rejected.

Faced with a mountain of particularized facts detailing the improper sales practices at Wells Fargo and the numerous warning signs the Directors consciously disregarded, Defendants ask the Court to accept speculative inferences favorable to them and against Plaintiffs, and to prejudge factual issues before discovery. That is an invitation to error, which the Court should decline. *See Lynch v. Rawls*, 429 F. App'x 641, 644 (9th Cir. 2011) (mem.) (reversing dismissal for lack of demand under Delaware law where district court "drew inferences in favor of

[10] The Directors also face a substantial risk of liability as to Plaintiffs' claim under Section 29(b) of the Exchange Act. ¶¶ 569-78; *In re Asyst Techs., Inc. Derivative Litig.*, No. C-06-04669 EDL, 2008 WL 4891220, at *9 (N.D. Cal. Nov. 12, 2008) (upholding Section 29(b) claim where plaintiffs alleged (i) "Asyst [wa]s in privity with the defendants" with respect to the subject contracts, (ii) defendants "engaged in prohibited conduct," and (iii) "Asyst [wa]s a party deserving protection under the securities laws").

Defendants rather than Plaintiffs, resolved factual inconsistencies without discovery, and analyzed Plaintiffs' allegations individually rather than collectively").

1. Defendants' preferred inferences are improper on this motion.

Defendants attempt to rebut Plaintiffs' allegations with their own spin and speculation regarding what they view as "more appropriate inference[s]" than those favoring Plaintiffs. But those "defendant-friendly" assumptions should be rejected. *LAMPERS*, 46 A.3d at 358.

First, Wells Fargo asks the Court (at 11) to assume the Company's termination of more than 5,300 employees for engaging in the illicit account-creation scheme was not "provided to the Directors before September 2016," and to question whether or why that information "would have[] struck the Directors as significant." Defendants go to great pains (at 2, 12) to emphasize Wells Fargo's size, which Defendants say renders the firing of those employees immaterial. Because those purported facts do not appear in the Complaint, they cannot be assumed true on this motion.[11] But it would be improper in any event for the Court to adopt the inference Defendants advocate, as opposed to the contrary, reasonable inference that the termination of thousands of employees—representing 5% of the Community Banking division—for substantially similar misconduct alerted the Directors that the unlawful practices were a systemic and ongoing issue for the Company. *See McCall v. Scott*, 239 F.3d 808, 821 (6th Cir. 2001) (concluding "it would be just as reasonable" for experienced directors to see a suspicious correlation as a sign of "possible improper billing activities" as it would be for them to see it as "the norm," and holding directors' indifference to that correlation supported liability); ¶ 19 (OCC Comptroller Curry testified, "I would say from the OCC's standpoint and the facts of this particular case, the fact that 5,300 employees were terminated was material and that there were two million accounts involved that would be material."). If, as Defendants posit (at 11), "the ultimate sanction" of termination sufficiently addressed the problem, it is difficult to imagine why the illicit account-creation scheme persisted *for years* and has resulted in hundreds of millions of

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[11] The incorporation-by-reference doctrine discussed in *Reiter v. Fairbank* (on which Defendants rely) applies only where, unlike here, "the unambiguous language of documents upon which the claims are based *contradict the complaint's allegations*." No. 11693-CB, 2016 WL 6081823, at *5 (Del. Ch. Oct. 18, 2016).

dollars in penalties and redress.

Second, Defendants attempt to minimize the significance of the numerous employee reports to the Company's EthicsLine regarding unlawful sales activities, and the letters and e-mails directed to Stumpf and/or the Board likewise alerting them to the same type of misconduct. Defendants contend (at 12), for example, the 2015 letter and e-mails Plaintiffs allege were sent to the Board "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." Defendants thus "essentially insist[] on a smoking gun of Board knowledge," which Delaware law does *not* require. *Rosenbloom*, 765 F.3d at 1156. Defendants likewise assert—before any discovery has taken place—that Plaintiffs' claims suffer from insufficient documentary evidence of employee complaints directed to the Board. But Defendants ignore the collective force of Plaintiffs' allegations, which sufficiently plead the Board's conscious inaction. *See id.* at 1155 (district court improperly "considered the factual allegations in isolation from each other rather than in combination, even though in cases like this one an inference of Board involvement or knowledge may depend on a combination of factual allegations"). Defendants further ask the Court (at 12-13) to infer that because Wells Fargo was firing employees at the same time those communications were directed to the Board, "Wells Fargo's control functions detected and dealt with the problems Plaintiffs complain about." But "focus[ing] on other hypothetical explanations for the defendants' conduct improperly ignores the rule that any inferences reasonably drawn from the factual allegations of the complaint must be viewed in the light most favorable to the plaintiffs." *Westmoreland Cnty. Emp. Ret. Sys. v. Parkinson*, 727 F.3d 719, 729 (7th Cir. 2013).

Third, Defendants erroneously assert (at 13) that the Court cannot consider the allegations by former employees alleging wrongful termination relating to the illicit account-creation scheme, and that "[e]ven meritorious allegations" in a lawsuit brought by one or several employees "are highly unlikely ever to make their way to a single member of Wells Fargo's Board." As an initial matter, Plaintiffs do not rely on the truth of those allegations as a "basis on which to state a claim" (*id.*), but rather as warning signs to the Board of unlawful sales

practices.[12] The Court can consider those legal proceedings in assessing what information was within the Board's control during the Relevant Period. *See In re Intuitive Surgical S'holder Derivative Litig.*, 146 F. Supp. 3d 1106, 1117 (N.D. Cal. 2015) (products-liability lawsuits constituted a "red flag"). As to the inference Defendants ask the Court to draw regarding the employment litigations, they once again attempt to elevate their unsupported speculation over reasonable inferences favoring Plaintiffs. It is reasonable to infer the Directors were aware of those legal proceedings, further demonstrating their conscious disregard of wrongdoing at the Company. *See id.* (in assessing demand futility, it was "reasonable to infer that the board would have been aware of any product liability lawsuits arising from the [subject product]"). The question is not whether the Directors were expected to read *all* of the thousands of complaints filed against Wells Fargo during the Relevant Period (*see* Defs.' Br. 13), but rather whether the Court reasonably can infer the Directors were aware of legal claims relating to unlawful and systemic sales practices at the Company that implicated their stated responsibilities and fiduciary obligations. ¶¶ 211-19. The categorical answer is yes.

Fourth, that Wells Fargo had internal controls in place does not immunize the Directors from liability, as Defendants suggest (at 18-19). The point of Plaintiffs' claims is that those controls were materially deficient and the Directors consciously failed to address those deficiencies, allowing the illicit account-creation scheme to persist for years. *See Rich v. Chong*, 66 A.3d 963, 984 (Del. Ch. 2013) ("When faced with knowledge that the company controls are inadequate, the directors must *act*, i.e., they must prevent further wrongdoing from occurring.") (emphasis in original). The same holds true with respect to the Wells Fargo teams charged with implementing proactive monitoring of data analytics to root out sales-practice violations. Defendants' assertion (at 14) that the Court should make "[a] more appropriate inference . . . 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" is precisely

[12] Defendants' reliance on *Maine State Retirement System v. Countrywide Financial Corp.*, in which plaintiff "copied allegations" from other cases against Countrywide to support plaintiff's claims against the company, is accordingly misplaced. No. 2:10-CV-0302 MRP (MANx), 2011 WL 4389689, at *20 (C.D. Cal. May 5, 2011).

the type of Defendant-friendly interpretation of the allegations the Court cannot make at this stage. *See Rosenbloom*, 765 F.3d at 1157-58 (that Allergan "maintain[ed] some formal policies prohibiting off-label promotion of drugs" did not preclude a finding that Plaintiffs' allegations "g[a]ve rise to a reasonable doubt that a majority of the directors adopted a plan premised on illegal off-label marketing of Botox").

Fifth, as with the numerous reports and employment actions relating to the illicit account-creation scheme, Defendants claim the December 2013 *L.A. Times* article, as well as the ensuing litigation by the L.A. City Attorney and the consumer class action, cannot support an inference that the Directors consciously disregarded the misconduct referenced in those sources. They are wrong. Defendants assert (at 14-15) that because the *L.A. Times* article—which Stumpf discussed with the Board (¶ 169)—reported the Company had dismissed over 30 employees and disciplined others for sales-practice violations, the Court must infer "management had detected and had dealt with" any problems. In the same vein, Defendants point to the statement by a Wells Fargo spokesman quoted in the article, who discussed the Company's "security procedures to root out employees who violate laws or bank ethics policy." But again, Plaintiffs are entitled at this stage to the inference that, particularly in light of the other red flags of misconduct appearing from 2007 onward, the Directors knew of those warnings and yet failed to cause the Company to meaningfully improve its internal controls or otherwise address the illicit account-creation scheme (or the overly aggressive sales-quota system that encouraged it).

Defendants also claim the lawsuits following in the wake of the *L.A. Times* article cannot be considered on this motion—which, as discussed above (*supra* pp. 19-20), is incorrect—and erroneously assert Plaintiffs allege the Directors should have been aware of those suits solely because of their positions on Board Committees. *Compare* Defs.' Br. at 15 *with* ¶¶ 100-10, 151-252 (detailing stated responsibilities of Committee members as well as the numerous red flags of serious wrongdoing).[13] Defendants also contend (at 16) the L.A. City Attorney's complaint

[13] Defendants' reference to the unremarkable proposition in *South v. Baker* that 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" is therefore misplaced. 62 A.3d 1, 17 (Del. Ch. 2012).

1 "likely would have communicated only that" actions Wells Fargo took with respect to sales
2 practices "were important and needed to continue." But "[w]hether the directors took appropriate
3 remedial action" is "a factual issue that reasonably could be disputed at this stage of the case."
4 *LAMPERS*, 46 A.3d at 358.

5 The facts of this case bear no resemblance to *Reiter v. Fairbank*, on which Defendants
6 rely. Plaintiff there alleged Capital One Financial Corporation's directors consciously
7 disregarded deficiencies in the company's program for complying with the Bank Secrecy Act and
8 other anti-money-laundering laws ("BSA/AML"), which exposed the company to risk related to
9 money laundering through its check-cashing business. 2016 WL 6081823, at *1. Unlike here,
10 Capital One board members received periodic reports explaining the risk exposure and
11 management's plans to address it, including "at least twenty-five reports" provided to the board's
12 Audit and Risk Committee and successor committees. *Id.* at *8. And unlike in this case,
13 plaintiff's allegations "evidence[d] that Capital One's management made efforts to cope with
14 tightening regulations and more aggressive AML enforcement actions," including "ultimately, the
15 decision to exit altogether the check cashing business that presented the most acute BSA/AML
16 challenges." *Id.* at *14. The significant management actions and reports to the board in *Reiter*
17 are far removed from Defendants' purported "remedial" efforts, which they were forced to take
18 following "consultation . . . with regulators and with the [L.A.] city attorney's office." ¶ 254.

19 *Sixth*, Defendants ask the Court (at 17) to infer there is "no reason to believe that the
20 Directors knew anything about" investigations by the OCC, CFPB, and FINRA relating to sales
21 practices at Wells Fargo. But Defendants ignore Plaintiffs' allegations, including Stumpf's
22 testimony that the Board learned "sometime in 2013" that Wells Fargo's regulators were
23 informed of the growing account-creation problem. ¶ 258; *see also id*. (Stumpf further testified:
24 "And I know in 2014, various committees of the Board were made aware of this. The risk
25 committee, the audit and examination [committee], the corporate responsibility [committee].").
26 Given the myriad other red flags described in the Complaint, and the critical importance of cross-
27 selling to the Company, it is reasonable to infer the Directors knew of those investigations, which
28 entailed: (i) several OCC Supervisory Letters (including MRAs) and a Report of Examination

concluding Wells Fargo Bank's sales practices were unethical, its actions caused harm to consumers, and Bank management had not responded promptly to address those issues; and (ii) a record $100 million fine from the CFPB. ¶¶ 220-37, 418-21. *See Stumpf*, 2012 WL 424557, at *7 ("Given that the Board cited compliance with regulatory investigations in its proxy statement and had already signed SEC statements certifying that the Company, through its CEO, was satisfied with its own internal reviews, defendants either knew or should have known the status of the Company's own and outside regulatory investigations into its mortgage practices.").[14] Further, Defendants' assertion (at 18) that the June 2015 OCC letter containing MRAs "would not have communicated an utter lack of control systems" is a strawman. It is sufficient that the Directors "conscious[ly] fail[ed] to act" in the face of "knowledge that the company controls are inadequate." *Rich*, 66 A.3d at 984. The Complaint meets that standard, as Plaintiffs allege the Directors failed to address the seriously deficient internal and disclosure controls that enabled the illicit account-creation scheme and helped perpetuate it for years. ¶ 377.

Finally, that Wells Fargo has now—more than nine years after red flags began alerting the Board to unlawful sales practices stemming from the overly aggressive sales-quota system—changed its commission-based sales policy does not exculpate the Directors. Quite the opposite: "The combination of *widespread* and *enduring* illegality in [Wells Fargo]'s corporate activity strongly supports an inference of Board knowledge and intentional disregard." *Rosenbloom*, 765 F.3d at 1154 (emphasis in original); *accord Intuitive Surgical*, 146 F. Supp. 3d at 1119.

2. Defendants' challenge to Plaintiffs' Section 10(b) claim relies on deeply flawed reasoning.

Plaintiffs' Section 10(b) claim is straightforward and grounded in well-recognized law. Plaintiffs allege the Directors (and the other Defendants) caused Wells Fargo to issue statements that, in light of the illicit account-creation scheme detailed above, were materially false or misleading when made. ¶¶ 213-410, 552-62. Plaintiffs further allege those misrepresentations

[14] While Defendants claim (at 17) the $1.5 million FINRA penalty had "nothing to do with" the unlawful creation of accounts, the deficiencies (including corporate governance failings) that led to the penalty—which related to failures to verify the identities of customers associated with new accounts (¶ 185)—plausibly contributed to the illicit account-creation scheme. The same holds true for the subset of OCC Supervisory Letters that addressed anti-money-laundering deficiencies at the Company, which Defendants also contend (at 17 n.14) are irrelevant. ¶¶ 46, 231.

artificially inflated the price of Wells Fargo shares, causing the Company to purchase approximately 772 million shares at artificially inflated prices through its stock repurchase program. ¶¶ 312-81.

Defendants' misconduct had two objectives, both of which were realized: *First*, by causing Wells Fargo to conduct share repurchases, Defendants signaled to investors their purported belief that Wells Fargo shares were trading at a discount, which caused investors to purchase shares and thereby increase the Bank's stock price. ¶ 313. Further, the Company's repurchase of shares artificially inflated its financial metrics such as earnings per share, as the repurchases resulted in fewer outstanding shares. *Id.* In addition to directly benefitting numerous Defendants (whose compensation was tied to the Company's financial performance), the artificial inflation of Wells Fargo shares helped mask, and thus perpetuate, the illicit account-creation scheme. *Id.* *Second*, as a result of the artificial inflation of the price of Wells Fargo shares, the Insider Selling Defendants collectively sold or otherwise disposed of over $629 million in Wells Fargo stock—in some instances, in transactions with the Company—at prices higher than they would have been absent the artificial inflation. ¶¶ 313, 382-94. In the face of significant red flags warning them of the illicit account-creation scheme, the Directors and other Defendants made numerous statements throughout the Relevant Period (including in Form 10-Ks and Proxy Statements signed or issued by the Directors) that failed to disclose the unlawful activity or the corresponding deficiencies in the Company's internal and disclosure controls. ¶¶ 237-311, 320-21, 327-81. Defendants, including the Directors, thus committed fraud in connection with the purchase or sale of securities, in violation of SEC Rule 10b-5. ¶¶ 312-410, 552-62.

Contrary to Defendants' invective (at 21 n.15) that "[t]his claim is one only a plaintiffs' lawyer could love," courts have upheld similar claims. Indeed, in *Countrywide* Judge Pfaelzer upheld 10b-5 claims based in part on allegations regarding the company's share-repurchase program, reasoning the repurchase program "could properly be viewed as an attempt to keep the ball rolling—i.e., to propel the Company forward (steadying the stock price, or sending it upward) for a period of time before the weight of the [allegedly improper] loan origination practices began taking its toll on the Company's operations and the value of its stock." 554 F.

1 Supp. 2d at 1066, 1068. The insiders' sales between November 2006 and May 2007 were
2 "entirely consistent with that view." *Id.* at 1068. The court's reasoning applies equally here.
3 Defendants also assert Wells Fargo cannot establish reliance "given that the knowledge of
4 the people who allegedly knowingly made those misstatements *is Wells Fargo's knowledge*."
5 Defs.' Br. 21 (emphasis in original). But numerous courts have declined to follow *In re VeriSign,*
6 *Inc., Derivative Litigation*, 531 F. Supp. 2d 1173 (N.D. Cal. 2007), the only case Defendants cite.
7 *See, e.g.*, *Countrywide*, 554 F. Supp. 2d at 1073 (rejecting defendants' argument, based on
8 *VeriSign*, that "[b]ecause Plaintiffs allege that the same persons who made the fraudulent
9 misstatements also made Countrywide's repurchase decision, . . . reliance here is impossible"). In
10 short, "if [Wells Fargo] issues or purchases stock at a loss, it does not do so recklessly—it is a
11 puppet whose strings are pulled by the very directors and officers responsible for the fraud." *In*
12 *re Finisar Corp. Derivative Litig.*, No. C-06-07660 RMW, 2012 WL 2873844, at *17 (N.D. Cal.
13 July 12, 2012). It is thus "not surprising that [D]efendants have failed to cite any cases following
14 *Verisign* under circumstances similar to those at issue here." *Id.* Defendants' challenge to
15 Plaintiffs' Section 10(b) claim accordingly fails.[15]

16
CONCLUSION

17 Defendants' motion to dismiss Plaintiffs' claims for lack of a demand should be denied.
18 Alternatively, if the Court grants the motion, Plaintiffs should be afforded leave to amend.
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[15] The Directors are also subject to liability as to Plaintiffs' additional claims. For example, the Directors were unjustly enriched by retaining bonuses, benefits, and other compensation at the expense of Wells Fargo and its shareholders, "against the fundamental principles of justice or equity or good conscience." *Jackson Nat'l Life Ins. Co. v. Kennedy*, 741 A.2d 377, 393 (Del. Ch. 1999); ¶¶ 538-40. And the court in *Countrywide* upheld a corporate-waste claim that was, like Plaintiffs' claim, based on a stock-repurchase program, which "may have served to delay the eventual impairment caused by unsound business practices." 554 F. Supp. 2d at 1078. The Directors' argument that those claims are merely duplicative of Plaintiffs' fiduciary-duty claim is unavailing: "If Plaintiffs succeed on the merits of their breach of fiduciary duty . . . claim[], it is likely they will also be able to prove that neither [of the defendants] can retain any benefit resulting from the disputed transaction 'justifiably' or in accordance with 'the fundamental principles of justice or equity and good conscience.' Plaintiffs, therefore, properly state an actionable claim for unjust enrichment . . . ." *Jackson Nat'l*, 741 A.2d at 394. Finally, as the California Supreme Court has yet to resolve whether Section 25403 of the California Corporations Code affords a private right of action, the Directors face a substantial risk of liability as to that claim. ¶¶ 584-88.

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