IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE THE GOLDMAN SACHS GROUP, INC. SHAREHOLDER LITIGATION	)))	Civil Action No. 5215-VCG

MEMORANDUM OPINION

Date Submitted: September 7, 2011
Date Decided: October 12, 2011

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GLASSCOCK, Vice Chancellor

The Delaware General Corporation Law is, for the most part, enabling in nature. It provides corporate directors and officers with broad discretion to act as they find appropriate in the conduct of corporate affairs. It is therefore left to Delaware case law to set a boundary on that otherwise unconstrained realm of action. The restrictions imposed by Delaware case law set this boundary by requiring corporate officers and directors to act as faithful fiduciaries to the corporation and its stockholders. Should these corporate actors perform in such a way that they are violating their fiduciary obligations—their core duties of care or loyalty—their faithless acts properly become the subject of judicial action in vindication of the rights of the stockholders. Within the boundary of fiduciary duty, however, these corporate actors are free to pursue corporate opportunities in any way that, in the exercise of their business judgment on behalf of the corporation, they see fit. It is this broad freedom to pursue opportunity on behalf of the corporation, in the myriad ways that may be revealed to creative human minds, that has made the corporate structure a supremely effective engine for the production of wealth. Exercising that freedom is precisely what directors and officers are elected by their shareholders to do. So long as such individuals act within the boundaries of their fiduciary duties, judges are ill-suited by training (and should be disinclined by temperament) to second-

guess the business decisions of those chosen by the stockholders to fulfill precisely that function. This case, as in so many corporate matters considered by this Court, involves whether actions taken by certain director defendants fall outside of the fiduciary boundaries existing under Delaware case law—and are therefore subject to judicial oversight—or whether the acts complained of are within those broad boundaries, where a law-trained judge should refrain from acting.

This matter is before me on a motion to dismiss, pursuant to Court of Chancery Rule 23.1, for failure to make a pre-suit demand upon the board, and Court of Chancery Rule 12(b)(6) for failure to state a claim. The Plaintiffs contend that Goldman's compensation structure created a divergence of interest between Goldman's management and its stockholders. The Plaintiffs allege that because Goldman's directors have consistently based compensation for the firm's management on a percentage of net revenue, Goldman's employees had a motivation to grow net revenue at any cost and without regard to risk.

The Plaintiffs allege that under this compensation structure, Goldman's employees would attempt to maximize short-term profits, thus increasing their bonuses at the expense of stockholders' interests. The Plaintiffs contend that Goldman's employees would do this by engaging in

highly risky trading practices and by over-leveraging the company's assets. If these practices turned a profit, Goldman's employees would receive a windfall; however, losses would fall on the stockholders.

The Plaintiffs allege that the Director Defendants breached their fiduciary duties by approving the compensation structure discussed above. Additionally, the Plaintiffs claim that the payments under this compensation structure constituted corporate waste. Finally, the Plaintiffs assert that this compensation structure led to overly-risky business decisions and unethical and illegal practices, and that the Director Defendants failed to satisfy their oversight responsibilities with regard to those practices.

The Defendants seek dismissal of this action on the grounds that the Plaintiffs have failed to make a pre-suit demand on the board and have failed to state a claim. For the reasons stated below, I find that the Plaintiffs' complaint must be dismissed.

I. FACTS

The facts below are taken from the second amended complaint. All reasonable inferences are drawn in the Plaintiffs' favor.[1]

[1] *See* Section II for a discussion of the applicable standard in a motion to dismiss.

A. Parties

Co-Lead plaintiffs Southeastern Pennsylvania Transportation Authority and International Brotherhood of Electrical Workers Local 98 Pension Fund ("the Plaintiffs") are stockholders of Goldman Sachs Group, Inc. ("Goldman"), and have continuously held Goldman stock during all relevant times.

Defendant Goldman is a global financial services firm which provides investment banking, securities, and investment management services to consumers, businesses, and governments. Goldman is a Delaware corporation with its principal executive offices in New York, NY.

The complaint also names fourteen individual current and former directors and officers of Goldman as defendants: Lloyd C. Blankfein, Gary D. Cohn, John H. Bryan, Claes Dahlback, Stephen Friedman, William W. George, Rajat K. Gupta, James A. Johnson, Lois D. Juliber, Lakshmi N. Mittal, James J. Schiro, Ruth J. Simmons, David A. Viniar, and J. Michael Evans (together with Goldman, "the Defendants").

Blankfein, Cohn, Bryan, Dahlback, Friedman, George, Gupta, Johnson, Juliber, Mittal, Schiro, and Simmons are current and former directors of Goldman, and are collectively referred to as the "Director Defendants." Evans and Viniar are officers of the company; Evans, Viniar,

Cohn, and Blankfein are collectively referred to as the "Executive Officer Defendants." Bryan, Dahlback, Friedman, George, Gutpa, Johnson, Juliber, Mittal, and Schiro served as members of the Board's Audit Committee (collectively, the "Audit Committee Defendants"). Finally, defendants Byran, Dahlback, Friedman, George, Gutpa, Johnson, Juliber, Mittal, Schiro, and Simmons served as members of the Board's Compensation Committee, and are collectively referred to as the "Compensation Committee Defendants."

B. Background

Goldman engages in three principal business segments: investment banking, asset management and securities services, and trading and principal investments. The majority of Goldman's revenue comes from the trading and principal investment segment.[2] In that segment Goldman engages in market making, structuring and entering into a variety of derivative transactions, and the proprietary trading of financial instruments.[3]

Since going public in 1999, Goldman's total assets under management and common stockholder equity have substantially increased.[4] In 1999, Goldman had $258 billion of assets under management and $10 billion of

[2] Compl. ¶ 37.
[3] Compl. ¶ 42. "Proprietary Trading" refers to a firm's trades for its own benefit with its own money.
[4] Compl. ¶ 36.

common shareholder equity.[5] By 2010, those numbers had grown to $881 billion of assets under management and $72.94 billion of common shareholder equity.[6] Corresponding with this increase in assets under management and common shareholder equity was a hike in the percentage of Goldman's revenue that was generated by the trading and principal investment segment.[7] In 1999, the trading and principal investment segment generated 43% of Goldman's revenue; by 2007 the segment generated over 76% of Goldman's revenue.[8]

As the revenue generated by the trading and principal investment segment grew, so did the trading department's stature within Goldman. The traders "became wealthier and more powerful in the bank."[9] The Plaintiffs allege that the compensation for these traders was not based on performance and was unjustifiable because Goldman was doing "nothing more than compensat[ing] employees for results produced by the vast amounts of shareholder equity that Goldman ha[d] available to be deployed."[10]

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[5] Compl. ¶ 36.
[6] *Id*.
[7] Compl. ¶ 109.
[8] *Id*.
[9] Compl. ¶ 49; *see also* Compl. ¶ 109.
[10] Compl. ¶ 92.

C. Compensation

Goldman employed a "pay for performance" philosophy linking the total compensation of its employees to the company's performance.[11] Goldman has used a Compensation Committee since at least 2006 to oversee the development and implementation of its compensation scheme.[12] The Compensation Committee was responsible for reviewing and approving the Goldman executives' annual compensation.[13] To fulfill their charge, the Compensation Committee consulted with senior management about management's projections of net revenues and the proper ratio of compensation and benefits expenses to net revenues (the "compensation ratio").[14] Additionally, the Compensation Committee compared Goldman's compensation ratio to that of Goldman's competitors such as Bear Stearns, Lehman Brothers, Merrill Lynch, and Morgan Stanley. The Compensation Committee would then approve a ratio and structure that Goldman would use to govern Goldman's compensation to its employees.[15]

The Plaintiffs allege that from 2007 through 2009, the Director Defendants approved a management-proposed compensation structure that

[11] Compl. ¶ 87.
[12] Compl. ¶ 89.
[13] *Id.*
[14] *Id.*
[15] Compl. ¶¶ 89-90.

caused management's interests to diverge from those of the stockholders.[16] According to the Plaintiffs, in each year since 2006 the Compensation Committee approved the management-determined compensation ratio, which governed "the total amount of funds available to compensate all employees including senior executives," without any analysis.[17] Although the total compensation paid by Goldman varied significantly each year, total compensation as a percentage of net revenue remained relatively constant.[18] Because management was awarded a relatively constant percentage of total revenue, management could maximize their compensation by increasing Goldman's total net revenue and total stockholder equity.[19] The Plaintiffs contend that this compensation structure led management to pursue a highly risky business strategy that emphasized short term profits in order to increase their yearly bonuses.[20]

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[16] Compl. ¶ 91.
[17] Compl. ¶¶ 90-91. Goldman's total net revenue was $46 billion in 2007, $22.2 billion in 2008, and $45.2 billion in 2009. Compl. ¶ 115. Goldman paid its employees total compensation of $20.2 billion in 2007, $10.9 billion in 2008, and $16.2 billion in 2009. Compl. ¶ 116. As a percentage of total net revenue, the total compensation paid by Goldman was 44% in 2007, 48% in 2008, and 36% in 2009. Compl. ¶ 115. The total compensation initially approved in 2007, by the Compensation Committee, was $16.7 billion or 47% of total revenue; however, this amount was changed after public outcry. Compl. ¶ 113.
[18] Compl. ¶ 115.
[19] Compl. ¶¶ 109-24.
[20] *See* Compl. ¶¶ 108, 124.

D. Business Risk

The Plaintiffs allege that management achieved Goldman's growth "through extreme leverage and significant uncontrolled exposure to risky loans and credit risks."[21] The trading and principal investment segment is the largest contributor to Goldman's total revenues; it is also the segment to which Goldman commits the largest amount of capital.[22] The Plaintiffs argue that this was a risky use of Goldman's assets, pointing out that Goldman's Value at Risk (VAR) increased between 2007 and 2009, and that in 2007 Goldman had a leverage ratio of 25 to 1, exceeding that of its peers.[23]

The Plaintiffs charge that this business strategy was not in the best interest of the stockholders, in part, because the stockholders did not benefit to the same degree that management did. Stockholders received roughly 2% of the revenue generated in the form of dividends—but if the investment went south, it was the stockholders' equity at risk, not that of the traders.

The Plaintiffs point to Goldman's performance in 2008 as evidence of these alleged diverging interests. In that year, "the Trading and Principal Investment segment produced $9.06 billion in net revenue, but as a result of

[21] Compl. ¶ 95.
[22] Compl. ¶¶ 37, 44. The segment generated 76% of Goldman's revenues in 2009, and as of December 2009, the segment also utilized 78% of the firm's assets. Compl. ¶ 43.
[23] Compl. ¶¶ 95, 136.

discretionary bonuses paid to employees *lost* more than $2.7 billion."[24] This contributed to Goldman's 2008 net income falling by $9.3 billion.[25] The Plaintiffs contend that, but for a cash infusion from Warren Buffet, federal government intervention and Goldman's conversion into a bank holding company, Goldman would have gone into bankruptcy.[26]

The Plaintiffs acknowledge that during this time Goldman had an Audit Committee in charge of overseeing risk.[27] The Audit Committee's purpose was to assist the board in overseeing "the Company's management of market, credit, liquidity, and other financial and operational risks."[28] The Audit Committee was also required to review, along with management, the financial information that was provided to analysts and ratings agencies and to discuss "management's assessment of the Company's market, credit, liquidity and other financial and operational risks, and the guidelines, policies and processes for managing such risks."[29]

In addition to having an Audit Committee in place, Goldman managed risk associated with the trading and principal investment section by hedging its positions—sometimes taking positions opposite to the clients that it was

[24] Compl. ¶ 92.
[25] Compl. ¶ 95.
[26] Compl. ¶¶ 132-33.
[27] Compl. ¶ 78.
[28] *Id.*
[29] *Id.*

investing with, advising, and financing.[30] Since 2002, Goldman has acknowledged that possible conflicts could occur and that it seeks to "manage" these conflicts.[31] The Plaintiffs allege that if the Audit Committee had been properly functioning, the board should have been forewarned about conflicts of interest between Goldman and its clients.[32]

The Plaintiffs contend that these conflicts of interest came to a head during the mortgage and housing crisis. In December 2006, Goldman's CFO, in a meeting with Goldman's mortgage traders and risk managers, concluded that the firm was over-exposed to the subprime mortgage market and decided to reduce Goldman's overall exposure.[33] In 2007, as the housing market began to decline, a committee of senior executives, including Viniar, Cohn, and Blankfein, took an active role in monitoring and overseeing the mortgage unit.[34] The committee's job was to examine mortgage products and transactions while protecting Goldman against risky deals.[35] The committee eventually decided to take positions that would allow Goldman to profit if housing prices declined.[36] When the subprime mortgage markets collapsed, not only were Goldman's long positions hedged, Goldman

[30] Compl. ¶¶ 51-52.
[31] Compl. ¶ 52.
[32] Compl. ¶ 78.
[33] Compl. ¶ 54.
[34] Compl. ¶ 59.
[35] *Id.*
[36] Compl. ¶ 60.

actually profited more from its short positions than it lost from its long positions.[37] The Plaintiffs allege that Goldman's profits resulted from positions that conflicted with its clients' interests to the detriment of the company's reputation.[38]

As an example of these conflicts of interest, the Plaintiffs point to the infamous Abacus transaction. In the Abacus transaction, hedge fund manager John Paulson, a Goldman client, had a role in selecting the mortgages that would ultimately be used to back a collateralized debt obligation (CDO).[39] Paulson took a short position that would profit if the CDO fell in value.[40] Goldman sold the long positions to other clients without disclosing Paulson's involvement.[41] On April 16, 2010, the SEC charged Goldman and a Goldman employee with fraud for their actions related to the Abacus transaction.[42] On July 14, 2010, Goldman settled the case with the SEC and agreed to pay a civil penalty of $535 million and to disgorge the

[37] Compl. ¶ 61.
[38] Compl. ¶¶ 64, 77, 84.
[39] Compl. ¶ 65. A CDO is a type of asset-backed security backed by a pool of bonds, loans, or other assets. The underlying assets' cash flow is used to make interest and principal payments to the holders of the CDO securities. CDO securities are issued in different classes, or tranches, that vary by their level of risk and maturity date. The senior tranches are paid first, while the junior tranches have higher interest rates or lower prices to compensate for the higher risk of default.
[40] *Id.*
[41] *Id.*
[42] Compl. ¶ 72.

$15 million in profits it made on the transaction.[43] Goldman also agreed to review its internal processes related to mortgage securities transactions.[44]

To demonstrate further examples of conflicts of interest, the Plaintiffs rely on a April 26, 2010 memorandum, from Senators Carl Levin and Tom Coburn to the Members of the Permanent Subcommittee on Investigations, entitled "Wall Street and the Financial Crisis: The Role of Investment Banks" ("Permanent Subcommittee Report"), that highlighted three mortgage-related products that Goldman sold to its clients.[45] These transactions involved synthetic CDOs,[46] where Goldman sold long positions to clients while Goldman took the short positions.[47] Unlike the Abacus transaction, these three transactions did not end with SEC involvement,[48] but the Plaintiffs allege that investors who lost money are "reviewing their options, including possibly bringing lawsuits."[49]

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[43] Compl. ¶ 73.
[44] *Id.*
[45] Compl. ¶¶ 75, 147.
[46] Synthetic CDOs are CDOs structured out of credit default swaps. A credit default swap (CDS) can essentially be thought of as an insurance policy on an asset such as a CDO or CDO tranche. The purchaser of the CDS pays a fixed amount at certain intervals to the seller of the CDS. If the CDO maintains its value, the seller of the CDS retains the money paid by the purchaser of the CDS; however, if the CDO falls in value, the seller of the CDS must pay the purchaser of the CDS for losses. Synthetic CDOs package CDSs together and use the cash flows from the CDSs to pay the purchasers of the CDO.
[47] Compl. ¶ 75.
[48] *Id.*
[49] Compl. ¶ 76.

E. The Plaintiffs' Claims

The Plaintiffs allege that the Director Defendants breached their fiduciary duties by (1) failing to properly analyze and rationally set compensation levels for Goldman's employees and (2) committing waste by "approving a compensation ratio to Goldman employees in an amount so disproportionately large to the contribution of management, as opposed to capital as to be unconscionable."[50]

The Plaintiffs also allege that the Director Defendants violated their fiduciary duties by failing to adequately monitor Goldman's operations and by "allowing the Firm to manage and conduct the Firm's trading in a grossly unethical manner."[51]

II. LEGAL STANDARDS

The Plaintiffs have brought this action derivatively on behalf of Goldman "to redress the breaches of fiduciary duty and other violations of law by [the] Defendants."[52] The Defendants have moved to dismiss, pursuant to Court of Chancery Rule 23.1, for failure to make a pre-suit demand upon the board, and Court of Chancery Rule 12(b)(6) for failure to state a claim.

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[50] Compl. ¶¶ 175-77.
[51] Compl. ¶ 186.
[52] Compl. ¶ 142.

A. Rule 12(b)(6)

As our Supreme Court has recently made clear, "the governing pleading standard in Delaware to survive a motion to dismiss is reasonable 'conceivability.'"[53] Under this minimal standard, when considering a motion to dismiss, the trial court must accept "even vague allegations in the Complaint as 'well-pleaded' if they provide the defendant notice of the claim."[54] The trial court must "draw all reasonable inferences in favor of the plaintiff, and deny the motion unless the plaintiff could not recover under any reasonably conceivable set of circumstances susceptible of proof."[55] This is true even if, "as a factual matter," it may "ultimately prove impossible for the plaintiff to prove his claims at a later stage of a proceeding."[56]

B. Rule 23.1

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[53] *Cent. Mortgage Capital Holdings v. Morgan Stanley*, 2011 WL 3612992, at *5 (Del. Aug. 18, 2011). That is, the pleading standard at the motion to dismiss stage in Delaware is "conceivability" as opposed to the higher "plausibility" standard that applies to federal civil actions. *Id.* (citing *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 556 (2007); *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009)). The difference, according to our Supreme Court, is that "[o]ur governing 'conceivability' standard is more akin to 'possibility,' while the federal 'plausibility' standard falls somewhere beyond mere 'possibility' but short of 'probability.'" *Central Mortgage*, 2011 WL 3612992, at *5 n.13.
[54] *Id.* at *5.
[55] *Id.*
[56] *Id.*

"[T]he pleading burden imposed by Rule 23.1 . . . is more onerous than that demanded by Rule 12(b)(6)."[57] Though a complaint may plead a "conceivable" allegation that would survive a motion to dismiss under Rule 12(b)(6), "vague allegations are . . . insufficient to withstand a motion to dismiss pursuant to Rule 23.1."[58] This difference reflects the divergent reasons for the two rules: Rule 12(b)(6) is designed to ensure a decision on the merits of any potentially valid claim, excluding only clearly meritless claims; Rule 23.1 is designed to vindicate the authority of the corporate board, except in those cases where the board will not or (because of conflicts) cannot exercise its judgment in the interest of the corporation. Rule 23.1 requires that "a plaintiff shareholder . . . make a demand upon the corporation's current board to pursue derivative claims owned by the corporation before a shareholder is permitted to pursue legal action on the corporation's behalf."[59] Demand is required because "[t]he decision whether to initiate or pursue a lawsuit on behalf of the corporation is generally within the power and responsibility of the board of directors."[60] Accordingly, the complaint must allege "with particularity the efforts, if any, made by the

[57] *McPadden v. Sidhu*, 964 A.2d 1262, 1269 (Del. Ch. 2008).
[58] *Id.*
[59] *In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 808, 820 (Del. Ch. 2005) (quoting *Jacobs v. Yang*, 2004 WL 1728521, at *2 (Del. Ch. Aug. 2, 2004), *aff'd*, 867 A.2d 902 (Del. 2005)).
[60] *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 120 (Del. Ch. 2009).

plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort."[61]

C. Demand Futility

If, as here, a stockholder does not first demand that the directors pursue the alleged cause of action, he must establish that demand is excused by satisfying "stringent [pleading] requirements of factual particularity" by "set[ting] forth particularized factual statements that are essential to the claim" in order to demonstrate that making demand would be futile.[62] Pre-suit demand is futile if a corporation's board is "deemed incapable of making an impartial decision regarding the pursuit of the litigation."[63]

Under the two-pronged test, first explicated in *Aronson*, when a plaintiff challenges a conscious decision of the board, a plaintiff can show demand futility by alleging particularized facts that create a reasonable doubt that either (1) the directors are disinterested and independent or (2) "the challenged transaction was otherwise the product of a valid exercise of business judgment."[64]

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[61] Ch. Ct. R. 23.1(a).
[62] *Citigroup*, 964 A.2d at 120-21 (internal quotations omitted); *McPadden*, 964 A.2d at 1269.
[63] *Beam v. Stewart*, 845 A.2d 1040, 1048 (Del. 2004).
[64] *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984).

On the other hand, when a plaintiff complains of board *inaction*, "there is no 'challenged transaction,' and the ordinary *Aronson* analysis does not apply."[65] Instead, the board's inaction is analyzed under *Rales v. Blasband*.[66] Under the *Rales* test, a plaintiff must plead particularized facts that "create a reasonable doubt that, as of the time the complaint [was] filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand."[67]

Here, the Plaintiffs concede that they have not made demand upon Goldman's board of directors, but they assert that such demand would be futile for numerous reasons. First, they argue that Goldman's board of directors is interested or lacks independence because of financial ties between the Director Defendants and Goldman.[68] Next, they allege that there is a reasonable doubt as to whether the board's compensation structure was the product of a valid exercise of business judgment.[69] The Plaintiffs further assert that there is a substantial likelihood that the Director Defendants will face personal liability for the dereliction of their duty to oversee Goldman's operations.[70]

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[65] *Citigroup*, 964 A.2d at 120.
[66] 634 A.2d 927 (Del. 1993).
[67] *Id*. at 934.
[68] Compl. ¶ 153.
[69] Compl. ¶¶ 169-79.
[70] Compl. ¶ 152.

I evaluate the Plaintiffs' claims involving active decisions by the board under *Aronson*. I evaluate the Plaintiffs' oversight claims against the Director Defendants for the failure to monitor Goldman's operations under *Rales*.

III. ANALYSIS

A. Approval of the Compensation Scheme

The Plaintiffs challenge the Goldman board's approval of the company's compensation scheme on three grounds. They allege (1) that the majority of the board was interested or lacked independence when it approved the compensation scheme, (2) the board did not otherwise validly exercise its business judgment, and (3) the board's approval of the compensation scheme constituted waste. Because the approval of the compensation scheme was a conscious decision by the board, the Plaintiffs must satisfy the *Aronson* test to successfully plead demand futility. I find that under all three of their challenges to the board's approval of the compensation scheme, the Plaintiffs have failed to adequately plead demand futility.

1. Independence and Disinterestedness of the Board

A plaintiff successfully pleads demand futility under the first prong of *Aronson* when he alleges particularized facts that create a reasonable doubt

that "a 'majority' of the directors could [have] impartially consider[ed] a demand" either because they were interested or lacked independence, as of the time that suit was filed.[71] Generally, "[a] director's interest may be shown by demonstrating a potential personal benefit or detriment to the director as a result of the decision."[72] A director is independent if the "director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences."[73]

When the complaint was originally filed, Goldman's board had 12 directors: Blankfein, Cohn, Bryan, Dahlback, Friedman, George, Gupta, Johnson, Juliber, Mittal, Schiro, and Simmons.[74] The Plaintiffs fail to allege that George and Schiro were interested or lacked independence. It can be assumed that Blankfein and Cohn, as officials of Goldman, would be found to be interested or lack independence. Therefore, the Plaintiffs must satisfy *Aronson* with respect to at least four of the remaining eight directors.[75]

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[71] *Beneville v. York*, 769 A.2d 80, 82 (Del. Ch. 2000).
[72] *Beam*, 845 A.2d at 1049; *Aronson*, 473 A.2d at 812 (To be considered disinterested, "directors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally.").
[73] *Aronson*, 473 A.2d at 816.
[74] Compl. ¶¶ 17-26.
[75] *See In re The Limited, Inc. S'holders Litig.*, 2002 WL 537692, at *7 (Del Ch. Mar. 27, 2002) ("[W]here the challenged actions are those of a board consisting of an even number of directors, plaintiffs meet their burden of demonstrating the futility of making demand on the board by showing that half of the board was either interested or not independent.").

The Plaintiffs argue that demand is excused because a majority of the Director Defendants lacked independence or were interested as a result of significant financial relationships with Goldman. The Plaintiffs contend that directors Bryan, Friedman, Gupta, Johnson, Juliber, and Simmons were interested because the private Goldman Sachs Foundation ("the Goldman Foundation") has made contributions to charitable organizations that the directors were affiliated with.[76] The Plaintiffs assert that directors Dahlback, Friedman, and Mittal were interested because of financial interactions with Goldman.

Below I provide the specific allegations found in the complaint about the Director Defendants. Since the Plaintiffs do not allege that the Director

[76] As an initial matter, the Plaintiffs fail to plead particularized facts that adequately create a reasonable doubt in regard to the Goldman Foundation's independence from Goldman. The Plaintiffs state that the Goldman Foundation's president is a managing director of Goldman and that, of the Goldman Foundation's eight board members, four "are or *were* managing directors of the Company." Compl. ¶ 155 (emphasis added). From the phrase "are or *were*," I can infer that at least one of the four board members affiliated with Goldman is no longer a managing director of Goldman; therefore, the Goldman Foundation's board had at least four members unaffiliated with Goldman and at least one member who was no longer affiliated with Goldman. Presumably these directors are independent and bound by the duties of loyalty and care to the Goldman Foundation. The Plaintiffs offer only conclusory statements that Goldman's management controls the Goldman Foundation. Without more, I have no basis to make an inference that Goldman's management dominated or controlled the Goldman Foundation. Regardless, even if the Plaintiffs had made an adequate showing that the Goldman Foundation was controlled by Goldman's management, the Plaintiffs do not plead particularized facts that create a reasonable doubt that the Defendants were interested or lacked independence based on the contributions from the Goldman Foundation, as described below.

Defendants (aside from Blankfein and Cohn) were interested in the compensation decisions, I analyze whether the director lacks independence.

a. Directors and Charitable Contributions.

i. John H. Bryan

Bryan has served as a Goldman director since 1999.[77] He was also a member of Goldman's Audit Committee and Goldman's Compensation Committee.[78] His charitable works included chairing a successful campaign to raise $100 million for the renovation of the Chicago Lyric Opera House and Orchestra Hall, and acting as a life trustee of the University of Chicago.[79] The Plaintiffs state that part of Bryan's responsibility, as a trustee, was to raise money for the University. The Plaintiffs note that Goldman has made "substantial contributions"[80] to the campaign to renovate the Chicago Lyric Opera House and Orchestra Hall and that the Goldman Foundation donated $200,000 to the University in 2006 and allocated an additional $200,000 in 2007.[81]

[77] Compl. ¶ 17.
[78] *Id.*
[79] Compl. ¶ 157.
[80] The Plaintiffs do not state the amount that Goldman donated, only that it was "substantial." *Id.*
[81] *Id.*

The Plaintiffs allege that because Goldman and the Goldman Foundation have assisted Bryan in his fund raising responsibilities, Bryan lacks independence.[82]

This Court has previously addressed directorial independence and charitable contributions. *Hallmark*[83] involved a special committee member who served on a variety of charitable boards where the charity received donations from the defendant corporation. The *Hallmark* Court noted that, even though part of the member's role was to act as a fund raiser, the member did not receive a salary for his work and did not actively solicit donations from the defendant corporation; therefore, the plaintiff failed to sufficiently show that the member was incapable of "exercising independent judgment."[84]

This Court also addressed charitable contributions in *J.P. Morgan*.[85] In that case, the plaintiff challenged the independence of a director who was the President and a trustee of the American Natural History Museum, another director who was a trustee of the American Natural History Museum, and a director who was the President and CEO of the United

[82] Compl. ¶ 163.
[83] *S. Muoio & Co. LLC v. Hallmark Entm't Inv. Co.*, 2011 WL 863007 (Del. Ch. Mar. 09, 2011).
[84] *Hallmark*, 2011 WL 863007, at *10.
[85] *J.P. Morgan*, 906 A.2d at 808.

Negro College Fund.[86] The plaintiff alleged that because the defendant corporation made donations to these organizations and was a significant benefactor, the directors lacked independence.[87] The Court decided that without additional facts showing, for instance, how the donations would affect the decision making of the directors or what percentage of the overall contribution was represented by the corporation's donations, the plaintiff had failed to demonstrate that the directors were not independent.[88]

In the case at bar, nothing more can be inferred from the complaint than the facts that the Goldman Foundation made donations to a charity that Bryan served as trustee, that part of Bryan's role as a trustee was to raise money, and that Goldman made donations to another charity where Bryan chaired a renovation campaign. The Plaintiffs do not allege that Bryan received a salary for either of his philanthropic roles, that the donations made by the Goldman Foundation or Goldman were the result of active solicitation by Bryan, or that Bryan had other substantial dealings with Goldman or the Goldman Foundation. The Plaintiffs do not provide the ratios of the amounts donated by Goldman, or the Goldman Foundation, to overall donations, or any other information demonstrating that the amount

[86] *Id*. at 814-15.
[87] *Id*.
[88] *Id*.

would be material to the charity. Crucially, the Plaintiffs fail to provide any information on how the amounts given influenced Bryan's decision-making process.[89] Because the complaint lacks such particularized details, the Plaintiffs have failed to create a reasonable doubt as to Bryan's independence.

ii. Rajat K. Gupta

Gupta has served as a Goldman director since 2006.[90] He was also a member of Goldman's Audit Committee and Goldman's Compensation Committee.[91] Gupta is chairman of the board of the Indian School of Business, to which the Goldman Foundation has donated $1.6 million since 2002.[92] Gupta is also a member of the dean's advisory board of Tsinghua University School of Economics and Management, to which the Foundation has donated at least $3.5 million since 2002.[93] Finally, Gupta is a member of the United Nations Commission on the Private Sector and Development and

[89] The Plaintiffs state that "[t]he Foundation's contributions to their fund raising responsibilities were material" because "[t]he SEC views a contribution for each director to be material if it equals or exceeds $10,000 per year." Compl. ¶ 163. The Plaintiffs argument is misguided. The Plaintiffs base this argument on 17 C.F.R. § 229.402(k)(2)(vii), which addresses director disclosure of perquisites and other benefits. As a threshold matter, 17 C.F.R. § 229.402(k)(2)(vii) is not Delaware law, does not define "materiality," and does not say that amounts over $10,000 are material. 17 C.F.R. § 229.402(k)(2)(vii) merely provides instruction for disclosure of perquisites and other benefits over $10,000. In any event, the Plaintiffs fail to provide any facts showing that the amounts would be material to any of the charitable organizations or the directors.
[90] Compl. ¶ 21.
[91] *Id.*
[92] Compl. ¶ 159.
[93] *Id.*

he is a special advisor to the UN Secretary General on UN Reform.[94] Since 2002, the Foundation has donated around $1.6 million to the Model UN program.[95] The Plaintiffs allege that as "a member of these boards and commission, it is part of Gupta's job to raise money."[96]

The Plaintiffs challenge to Gupta's independence fails for reasons similar to Bryan's. The Plaintiffs allegations only provide information that shows that Gupta was engaged in philanthropic activities and that the Goldman foundation made donations to charities to which Gupta had ties. The Plaintiffs do not mention the materiality of the donations to the charities or any solicitation on the part of Gupta. The Plaintiffs do not state how Gupta's decision-making was altered by the donations. Without such particularized allegations, the Plaintiffs fail to raise a reasonable doubt that Gupta was independent.

iii. James A. Johnson

Johnson has served as a Goldman director since 1999.[97] He was also a member of Goldman's Audit Committee and Goldman's Compensation Committee.[98] Johnson is an honorary trustee of the Brookings Institution.[99]

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[94] *Id.*
[95] *Id.*
[96] *Id.*
[97] Compl. ¶ 22.
[98] Johnson is listed as both an Audit Committee Defendant and a Compensation Committee Defendant. Compl. ¶¶ 32-33. The Plaintiffs state in Compl. ¶ 22., which

The Plaintiffs allege that part of Johnson's role as a trustee is to raise money and that the Foundation donated $100,000 to the Brookings Institution in 2006.[100]

Again the Plaintiffs fail to provide any information other than that a director was affiliated with a charity and the Goldman Foundation made a donation to that charity. Without more, the Plaintiffs fail to provide particularized factual allegations that create a reasonable doubt in regards to Johnson's independence.

iv. Lois D. Juliber

Juliber has served as a Goldman director since 2004.[101] She was also a member of Goldman's Audit Committee and Goldman's Compensation Committee.[102] Juliber is a member of the board of Girls Incorporated, a charitable organization, to which the Plaintiffs contend that the Goldman Foundation donated $400,000 during 2006 and 2007.[103] The Plaintiffs allege

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discusses Johnson's role at Goldman, that "Defendant Dahlback has served as a member of both the Audit Committee and the Compensation Committee during the relevant period." I assume that the Plaintiffs made a typographical error and meant to refer to Johnson rather than Dahlback.

[99] Compl. ¶ 158.

[100] *Id.*

[101] Compl. ¶ 23.

[102] *Id.*

[103] Compl. ¶ 161; *see* Compl. ¶ 156.

that part of Juliber's job as a Girls Incorporated board member is to raise money.[104]

For the same reasons that the Plaintiffs' allegations fall short for directors Bryan, Gupta, and Johnson, the Plaintiffs' allegations fall short here. The Plaintiffs do not plead facts sufficient to create a reasonable doubt whether Juliber was independent.

v. Ruth J. Simmons

Simmons has served as a Goldman director since 2000.[105] She was also a member of Goldman's Compensation Committee.[106] Simmons is President of Brown University, and the Plaintiffs allege that part of her job is to raise money for the University.[107] The Plaintiffs note that "[t]he [Goldman] Foundation has pledged funding in an undisclosed amount to share in the support of a position of Program Director at The Swearer Center for Public Service at Brown University," and so far $200,000 has been allocated to this project.[108]

Simmons differs from the other directors in that, rather than sitting on a charitable board, as the other defendants do, Simmons livelihood as President of Brown University does directly depend on her fundraising

[104] Compl. ¶ 161.
[105] Compl. ¶ 26.
[106] *Id.*
[107] Compl. ¶ 162.
[108] *Id.*

abilities;[109] however, the Plaintiffs fail to allege particularized factual allegations that create a reasonable doubt that Simmons was independent.

The Plaintiffs provide the amount donated to Brown University, but do not give any additional information showing the materiality of the donation to Brown University. The Plaintiffs do not provide the percentage this amount represented of the total amount raised by Brown, or even how this amount was material to the Swearer Center. Additionally, the Plaintiffs' allegations do not provide information that Simmons actively solicited this amount or how this or potential future donations would affect Simmons. The facts pled are insufficient to raise the inference that Simmons feels obligated to the foundation or Goldman management. Consequently, the factual allegations pled by the Plaintiffs fail to raise a reasonable doubt that, despite Simmons's position as President of Brown University, she remained independent.

b. Directors with Other Alleged Interests.

The Plaintiffs allege that three directors have, in addition (in the case of Mr. Friedman) to charitable connections to Goldman or the Goldman Foundation, business dealings with Goldman that render them dependent for

[109] Though the Plaintiffs do not make an explicit statement in the complaint, I make a reasonable inference that Simmons role, as an employee of the University, is different from the roles of other defendants who sit on charitable boards.

purposes of the first prong of the *Aronson* analysis. Having already found that a majority of the Goldman board was independent, I could simply omit analysis of the independence of these directors under *Aronson*. I will briefly address the Plaintiffs contentions with respect to the directors below.

i. Stephen Friedman

Friedman has served as a Goldman director since 2005.[110] He was also a member of Goldman's Audit Committee and Goldman's Compensation Committee.[111] The Plaintiffs allege that Friedman lacks independence for two reasons. First, the Plaintiffs allege that Friedman is not independent because of his philanthropic work and Goldman's advancement thereof. Second, the Plaintiffs allege that Friedman is not independent due to his business dealings with Goldman.

Friedman is an emeritus trustee of Columbia University.[112] The Plaintiffs contend that part of his job as a trustee is to raise money for Columbia University and that since 2002 the Goldman foundation has donated at least $765,000 to Columbia University.[113]

Taken by themselves, the facts pled, concerning Friedman's charitable connection to the Goldman Foundation, are insufficient to create a

[110] Compl. ¶ 19.
[111] *Id.*
[112] Compl. ¶ 160.
[113] *Id.*

reasonable doubt that Friedman was independent. Similar to the Plaintiffs' other allegations concerning defendants with charitable connections to the Goldman Foundation, the Plaintiffs only allege that Friedman is a trustee of Columbia University, that part of his job as a trustee is to raise money, and that the Foundation has donated money to the University. The complaint fails to allege that Friedman solicited money from the Goldman Foundation, that he receives any salary for his work as trustee, or that he had any substantial dealings with the Goldman Foundation.

Besides their allegations concerning Friedman's charitable endeavors, the Plaintiffs also allege that Goldman "*has* invested at least $670 million in funds managed by Friedman."[114] This is the entirety of the pleadings regarding Friedman's business involvement with Goldman. Contrary to the contentions in the Plaintiffs' Answering Brief, the complaint does not allege that Friedman relies on the management of these funds for his livelihood; that contention, if buttressed by factual allegations in the complaint, might reasonably demonstrate lack of independence. The complaint is insufficient, as written, for that purpose.

ii. Claes Dahlback

[114] *Id*. (emphasis added). The use of the word "has" does not necessarily suggest that Goldman's investment currently is this amount, nor does it indicate that such funds were invested during the relevant period.

Dahlback has served as a Goldman director since 2003.[115] He was also a member of Goldman's Audit Committee and Goldman's Compensation Committee.[116] Besides serving on Goldman's board, Dahlback is a senior advisor to an entity described in the complaint as "Investor AB."[117] The Plaintiffs note that Goldman has invested more than $600 million in funds to which Dahlback is an adviser (presumably, but not explicitly, Investor AB).[118] The Plaintiffs contend that because Dahlback had substantial financial relationships with Goldman, he lacked independence.

The Plaintiffs' allegations regarding Dahlback are sparse and tenuous. "[T]he complaint contains no allegations of fact tending to show that [any] fees paid were material to [Dahlback]."[119] The Plaintiffs only note that Dahlback is an advisor to Investor AB, and that Goldman has invested more than $600 million in funds with an entity to which Dahlback is an advisor. Contrary to the statements by the Plaintiffs in the answering brief, the complaint does not allege that Dahlback's "livelihood depends on his full-time job as an advisor." The Plaintiffs fail to allege that Dahlback derives a substantial benefit from being an advisor to Investor AB, that Dahlback

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[115] Compl. ¶ 18.
[116] *Id.*
[117] Compl. ¶ 165. The complaint also alleges that Dahlback was an executive director of a second entity, "Thisbe AB." *Id.*
[118] *Id.*
[119] *White v. Panic*, 793 A.2d 356, 366 (Del. Ch. 2000).

solicited funds from Goldman, that Investor AB received funds because of Dahlback's involvement, or any other fact that would tend to raise a reasonable doubt that Dahlback's future employment with Investor AB is independent of Goldman's investment. As with defendant Friedman, the pleadings are insufficient to raise a reasonable doubt as to Dahlback's independence.

iii. Lakshmi N. Mittal

Mittal has served as a Goldman director since 2008.[120] He was also a member of Goldman's Audit Committee and Goldman's Compensation Committee.[121] Mittal is the chairman and CEO of ArcelorMittal.[122] The Plaintiffs allege that "Goldman has arranged or provided billions of euros in financing to his company" and that "[d]uring 2007 and 2008 alone, the Company had made loans to AcelorMittal [sic] in the aggregate amount of 464 million euros."[123]

Goldman is an investment bank. The fact "[t]hat it provided financing to large . . . companies should come as no shock to anyone. Yet this is all that the plaintiffs allege."[124] The Plaintiffs fail to plead facts that show anything other than a series of market transactions occurred between

[120] Compl. ¶ 24.
[121] *Id.*
[122] Compl. ¶ 166.
[123] *Id.*
[124] *J.P. Morgan*, 906 A.2d at 822.

ArcelorMittal and Goldman. For instance, the Plaintiffs have not alleged that ArcelorMittal is receiving a discounted interest rate on the loans from Goldman, that Mittal was unable to receive financing from any other lender, or that loans from Goldman compose a substantial part of ArcelorMittal's funding.[125] The pleadings fail to raise a reasonable doubt as to the independence of Mittal.

B. Otherwise the Product of a Valid Exercise of Business Judgment

Having determined that the Plaintiffs have not pled particularized factual allegations that raise a reasonable doubt as to a majority of the Director Defendants' disinterestedness and independence, I must now apply the second prong of *Aronson* and determine whether the Plaintiffs have pled particularized facts that raise a reasonable doubt that Goldman's compensation scheme was otherwise the product of a valid exercise of business judgment.[126] To successfully plead demand futility under the second prong of *Aronson*, the Plaintiffs must allege "particularized facts sufficient to raise (1) a reason to doubt that the action was taken honestly and in good faith or (2) a reason to doubt that the board was adequately

[125] If anything, the Plaintiffs' allegations suggest that Goldman may be dependent on Mittal for future fees generated by underwriting his debt offerings.
[126] *Aronson*, 473 A.2d at 814; *Brehm v. Eisner*, 746 A.2d 244, 256 (Del. 2000).

informed in making the decision."[127] Goldman's charter has an 8 *Del. C.* § 102(b)(7) provision, providing that the directors are exculpated from liability except for claims based on 'bad faith' conduct; therefore, the Plaintiffs must also plead particularized facts that demonstrate that the directors acted with scienter; i.e., there was an "intentional dereliction of duty" or "a conscious disregard" for their responsibilities, amounting to bad faith.[128]

The Plaintiffs assert that the Director Defendants owed "a fiduciary duty to assess continually Goldman's compensation scheme to ensure that it reasonably compensated employees and reasonably allocated the profit of Goldman's activities according to the contributions of shareholder capital and the employees of the Company."[129] The Plaintiffs contend that the entire compensation structure put in place by the Director Defendants was done in bad faith and that the Director Defendants were not properly informed when making compensation awards.[130] I find that the Plaintiffs have not provided particularized factual allegations that raise a reasonable doubt whether the process by which Goldman's compensation scheme allocated profits

[127] *J.P. Morgan*, 906 A.2d at 824 (quoting *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275, 286 (Del. Ch. 2003) (Disney II)).
[128] *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 755 (Del. Ch. 2005) (Disney III).
[129] Compl. ¶ 170.
[130] *See* Compl. ¶¶ 169-79.

between the employees and shareholders was implemented in good faith and on an informed basis.

1. Good Faith

"[A] failure to act in good faith requires conduct that is qualitatively different from, and more culpable than, the conduct giving rise to a violation of the fiduciary duty of care (i.e., gross negligence)."[131] Examples of this include situations where the fiduciary intentionally breaks the law, "where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation," or "where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties."[132] While this is not an exclusive list, "these three are the most salient."[133]

The third category above falls between "conduct motivated by subjective bad intent," and "conduct resulting from gross negligence."[134] "Conscious disregard" involves an "intentional dereliction of duty" which is "more culpable than simple inattention or failure to be informed of all facts material to the decision."[135]

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[131] *Stone v. Ritter*, 911 A.2d 362, 369 (Del. 2006).
[132] *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 67 (Del. 2006) (Disney IV).
[133] *Id*.
[134] *See Id*. at 66.
[135] *Id*.

The Plaintiffs' main contention is that Goldman's compensation scheme itself was approved in bad faith. The Plaintiffs allege that "[n]o person acting in good faith on behalf of Goldman consistently could approve the payment of between 44% and 48% of net revenues to Goldman's employees year in and year out"[136] and that accordingly the Director Defendants abdicated their duties by engaging in these "practices that overcompensate management."[137] The complaint is entirely silent with respect to any individual salary or bonus; the Plaintiffs' allegation is that the scheme so misaligns incentives that it cannot have been the product of a good faith board decision.

The Plaintiffs' problems with the compensation plan structure can be summarized as follows: Goldman's compensation plan is a positive feedback loop where employees reap the benefits but the stockholders bear the losses. Goldman's plan incentivizes employees to leverage Goldman's assets and engage in risky behavior in order to maximize yearly net revenue and their yearly bonuses. At the end of the year, the remaining revenue that is not paid as compensation, with the exception of small dividend payments to stockholders, is funneled back into the company. This increases the

[136] Compl. ¶ 172.
[137] Compl. ¶ 176. Actually, the percentage of revenue devoted to compensation was 44%, 48%, and 36% for the years 2007, 2008, and 2009, respectively. Compl. ¶ 123.

quantity of assets Goldman employees have available to leverage and invest. Goldman employees then start the process over with a greater asset base, increase net revenue again, receive even larger paychecks the next year, and the cycle continues. At the same time, stockholders are only receiving a small percentage of net revenue as dividends; therefore, the majority of the stockholders' assets are simply being cycled back into Goldman for the Goldman employees to use.

The stockholders' and Goldman employees' interests diverge most notably, argue the Plaintiffs, when there is a drop in revenue. If net revenues fall, the stockholders lose their equity, but the Goldman employees do not share this loss.[138]

The decision as to how much compensation is appropriate to retain and incentivize employees, both individually and in the aggregate, is a core function of a board of directors exercising its business judgment. The Plaintiffs' pleadings fall short of creating a reasonable doubt that the Directors Defendants have failed to exercise that judgment here. The Plaintiffs acknowledge that the compensation plan authorized by Goldman's board, which links compensation to revenue produced, was intended to align employee interests with those of the stockholders and incentivize the

[138] In actuality, of course, a drop in revenue *does* have a direct negative impact on employees, because their income is tied to revenue.

production of wealth. To an extent, it does so: extra effort by employees to raise corporate revenue, if successful, is rewarded. The Plaintiffs' allegations mainly propose that the compensation scheme implemented by the board does not perfectly align these interests; and that, in fact, it may encourage employee behavior incongruent with the stockholders' interest. This may be correct, but it is irrelevant. The fact that the Plaintiffs may desire a different compensation scheme does not indicate that equitable relief is warranted. Such changes may be accomplished through directorial elections, but not, absent a showing unmet here, through this Court.

Allocating compensation as a percentage of net revenues does not make it virtually inevitable that management will work against the interests of the stockholders. Here, management was only taking a percentage of the net revenues. The remainder of the net revenues was funneled back into the company in order to create future revenues; therefore, management and stockholder interests were aligned. Management would increase its compensation by increasing revenues, and stockholders would own a part of a company which has more assets available to create future wealth.

The Plaintiffs' focus on percentages ignores the reality that over the past 10 years, in absolute terms, Goldman's net revenue and dividends have

substantially increased.[139] Management's compensation is based on net revenues. Management's ability to generate that revenue is a function of the total asset base, which means management has an interest in maintaining that base (owned, of course, by the Plaintiffs and fellow shareholders) in order to create future revenues upon which its future earnings rely.

The Plaintiffs argue that there was an intentional dereliction of duty or a conscious disregard by the Director Defendants in setting compensation levels; however, the Plaintiffs fail to plead with particularity that any of the Director Defendants had the scienter necessary to give rise to a violation of the duty of loyalty.[140] The Plaintiffs do not allege that the board failed to employ a metric to set compensation levels; rather, they merely argue that a different metric, such as comparing Goldman's compensation to that of hedge fund managers rather than to compensation at other investment banks, would have yielded a better result.[141] But this observance does not make the board's decision self-evidently wrong, and it does not raise a reasonable doubt that the board approved Goldman's compensation structure in good faith.

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[139] Compl. ¶ 123.
[140] *See* Compl. ¶¶ 169-76.
[141] Compl. ¶ 89.

2. Adequately Informed

The Plaintiffs also contend that the board was uninformed in making its compensation decision. "Pre-suit demand will be excused in a derivative suit only if the . . . particularized facts in the complaint create a reasonable doubt that the informational component of the directors' decisionmaking process, *measured by concepts of gross negligence*, included consideration of all material information reasonably available."[142] Here, Goldman's charter has a 8 *Del. C.* § 102(b)(7) provision, so gross negligence, by itself, is insufficient basis upon which to impose liability. The Plaintiffs must allege particularized facts creating a reasonable doubt that the directors acted in good faith.

The Plaintiffs allege that the Director Defendants fell short of this reasonableness standard in several ways. They point out that the Director Defendants never "analyzed or assessed the extent to which management performance, as opposed to the ever-growing shareholder equity and assets available for investment, has contributed to the generation of net revenues."[143] The Plaintiffs also argue that because the amount of stockholder equity and assets available for investment was responsible for the total revenue generated, the Director Defendants should have used other

[142] *Brehm*, 746 A.2d at 259.
[143] Compl. ¶ 171.

metrics, such as compensation levels at shareholder funds and hedge funds, to decide compensation levels at Goldman.[144] The Plaintiffs allege that Goldman's performance, on a risk adjusted basis, lagged behind hedge fund competitors, yet the percentage of net revenue awarded did not substantially vary, and that the Director Defendants never adequately adjusted compensation in anticipation of resolving future claims.[145]

Nonetheless, the Plaintiffs acknowledge that Goldman has a compensation committee that reviews and approves the annual compensation of Goldman's executives.[146] The Plaintiffs also acknowledge that Goldman has adopted a "pay for performance" philosophy, that Goldman represents as a way to align employee and shareholder interests.[147] The Plaintiffs further acknowledge that Goldman's compensation committee receives information from Goldman's management concerning Goldman's net revenues and the ratio of compensation and benefits expenses to net revenues.[148] Finally, the Plaintiffs note that the compensation committee reviewed information relating to the compensation ratio of Goldman's "core

[144] *Id.*
[145] Compl. ¶¶ 7, 131; *see also* Compl. ¶¶ 104-06.
[146] Compl. ¶ 89.
[147] Compl. ¶¶ 85-88
[148] Compl. ¶ 89.

competitors that are investment banks (Bear Stearns, Lehman Brothers, Merrill Lynch, and Morgan Stanley)."[149]

Rather than suggesting that the Director Defendants acted on an uninformed basis, the Plaintiffs' pleadings indicate that the board adequately informed itself before making a decision on compensation. The Director Defendants considered other investment bank comparables, varied the total percent and the total dollar amount awarded as compensation, and changed the total amount of compensation in response to changing public opinion.[150] None of the Plaintiffs' allegations suggests gross negligence on the part of the Director Defendants, and the conduct described in the Plaintiffs' allegations certainly does not rise to the level of bad faith such that the Director Defendants would lose the protection of an 8 *Del. C.* § 102(b)(7) exculpatory provision.

At most, the Plaintiffs' allegations suggest that there were other metrics not considered by the board that might have produced better results. The business judgment rule, however, only requires the board to *reasonably* inform itself; it does not require perfection or the consideration of every

[149] *Id.*
[150] Compl. ¶¶ 86, 89, 113, 115.

conceivable alternative.[151] The factual allegations pled by the Plaintiffs, therefore, do not raise a reasonable doubt that the board was informed when it approved Goldman's compensation scheme.

3. Waste

The Plaintiffs also contend that Goldman's compensation levels were unconscionable and constituted waste. To sustain their claim that demand would be futile, the Plaintiffs must raise a reasonable doubt that Goldman's compensation levels were the product of a valid business judgment. Specifically, to excuse demand on a waste claim, the Plaintiffs must plead particularized allegations that "overcome the general presumption of good faith by showing that the board's decision was so egregious or irrational that it could not have been based on a valid assessment of the corporation's best interests."[152]

"[W]aste entails an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade."[153] Accordingly, if "there is any *substantial* consideration received by the corporation, and if there is a *good faith*

[151] *See Brehm*, 746 A.2d at 259 ("[T]he standard for judging the informational component of the directors' decisionmaking does not mean that the Board must be informed of *every* fact.").
[152] *Citigroup*, 964 A.2d at 136 (quoting *White v. Panic*, 783 A.2d 543, 554 n.36 (Del. 2001)).
[153] *Lewis v. Vogelstein*, 699 A.2d 327, 336 (Del. Ch. 1997).

judgment that in the circumstances the transaction is worthwhile, there should be no finding of waste."[154] The reason being, "[c]ourts are ill-fitted to attempt to weigh the 'adequacy' of consideration under the waste standard or, *ex post*, to judge appropriate degrees of business risk."[155] Because of this, "[i]t is the essence of business judgment for a board to determine if a particular individual warrant[s] large amounts of money."[156]

The Plaintiffs' waste allegations revolve around three premises: that Goldman's pay per employee is significantly higher than its peers, that Goldman's compensation ratios should be compared to hedge funds and other shareholder funds to reflect Goldman's increasing reliance on proprietary trading as opposed to traditional investment banking services, and that Goldman's earnings and related compensation are only the result of risk taking.

The Plaintiffs consciously do not identify a particular individual or person who received excessive compensation, but instead focus on the average compensation received by each of Goldman's 31,000 employees.[157] The Plaintiffs allege that "Goldman consistently allocated and distributed anywhere from two to six times the amounts that its peers distributed to each

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[154] *Id.*
[155] *Id.*
[156] *Brehm*, 746 A.2d at 263 (internal quotations omitted).
[157] Compl. ¶¶ 119-20.

employee,"[158] and the Plaintiffs provide comparisons of Goldman's average pay per employee to firms such as Morgan Stanley, Bear Stearns, Merrill Lynch, Citigroup, and Bank of America.[159] The Plaintiffs note that these firms are investment banks, but do not provide any indication of why these firms are comparable to Goldman or their respective primary areas of business. The Plaintiffs do not compare trading segment to trading segment or any other similar metric. A broad assertion that Goldman's board devoted more resources to compensation than did other firms, standing alone, is not a particularized factual allegation creating a reasonable doubt that Goldman's compensation levels were the product of a valid business judgment.

The Plaintiffs urge that, in light of Goldman's increasing reliance on proprietary trading, Goldman's employees' compensation should be compared against a hedge fund or other shareholder fund.[160] The Plaintiffs allege that Goldman's compensation scheme is equal to 2% of net assets and 45% of the net income produced, but a typical hedge fund is only awarded 2% of net assets and 20% of the net income produced.[161] The Plaintiffs

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[158] Compl. ¶ 91.
[159] Compl. ¶ 119.
[160] Compl. ¶¶ 117-18.
[161] Compl. ¶ 117. The Defendants dispute the Plaintiffs allegations that Goldman's compensation scheme is equal to 2% of net assets under management and 45% of the net income produced. In the Defendants' reply brief, in further support of their motion to dismiss the second amended complaint, the Defendants state that if a 2 and 20 compensation scheme would have been used the total 2009 compensation awarded by

paradoxically assert that "no hedge fund manager may command compensation for managing assets at the annual rate of 2% of net assets and 45% of net revenues," but then immediately acknowledge that in fact there are hedge funds that have such compensation schemes.[162] It is apparent to me from the allegations of the complaint that while the majority of hedge funds may use a "2 and 20" compensation scheme, this is not the exclusive method used too set such compensation. Even if I were to conclude that a hedge fund or shareholder fund would be an appropriate yardstick with which to measure Goldman's compensation package and "even though the amounts paid to defendants exceeded the industry average," I fail to see a "shocking disparity" between the percentages that would render them "legally excessive."[163]

In the end, while the Goldman employees may not have been doing, in the words of the complaint and Defendant Blankfein, "God's Work,"[164] the complaint fails to present facts that demonstrate that the work done by Goldman's 31,000 employees was of such limited value to the corporation that no reasonable person in the directors' position would have approved

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Goldman would have been $19.7 billion, as opposed to the $16.2 billion actually awarded. Regardless, for the reasons I have noted above, I conclude that the Plaintiffs have not pled particularized facts necessary to carry their burden.

[162] Compl. ¶ 118.

[163] *Saxe v. Brady*, 184 A.2d 602, 610 (Del. Ch. 1962).

[164] Compl. ¶ 126.

their levels of compensation.[165] Absent such facts, these decisions are the province of the board of directors rather than the courts.[166] Without examining the payment to a specific individual, or group of individuals, and what was specifically done in exchange for that payment, I am unable to determine whether a transaction is "so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration."[167]

The closest the Plaintiffs come to pleading waste with any factual particularity is in regards to the payment to the Trading and Principal Investment segment in 2008. The Plaintiffs allege that in 2008 "the Trading and Principal Investments segment produced $9.06 billion in net revenue, but, as a result of discretionary bonuses paid to employees, lost more than $2.7 billion for the [stockholders]."[168] The Plaintiffs' allegations, however, are insufficient to raise a reasonable doubt that Goldman's compensation levels in this segment were the product of a valid business judgment. As a strictly pedagogic exercise, imagine a situation where one half of the traders lost money, and the other half made the same amount of money, so that the firm broke even. Even if no bonus was awarded to the half that lost money, a

[165] *Brehm*, 746 A.2d at 263.
[166] *Id*.
[167] *Id*. (quoting *In re Walt Disney Co. Deriv. Litig.*, 731 A.2d 342, 362 (Del. Ch. 1998) (Disney I)).
[168] Compl. ¶ 92.

rational manager would still want to award a bonus to the half that did make money in order to keep that talent from leaving. Since net trading gains were $0, these bonuses would cause a net loss, but there would not be a waste of corporate assets because there was adequate consideration for the bonuses. Without specific allegations of unconscionable transactions and details regarding who was paid and for what reasons they were paid, the Plaintiffs fail to adequately plead demand futility on the basis of waste.

Finally, the Plaintiffs herald the fact that during the sub-prime crisis the Director Defendants continued to allocate similar percentages of net revenue as compensation while the firm was engaged in risky transactions; however, "there should be no finding of waste, even if the fact finder would conclude *ex post* that the transaction was unreasonably risky. Any other rule would deter corporate boards from the optimal rational acceptance of risk."[169] Because this complaint lacks a particular pleading that an individual or group of individuals was engaged in transactions so unconscionable that no rational director could have compensated them, the Plaintiffs have failed to raise a reasonable doubt that the compensation decisions were not the product of a valid business judgment.

D. The Plaintiffs' Caremark *Claim*

[169] *Lewis*, 699 A.2d at 336.

In addition to the claims addressed above, the Plaintiffs assert that the board breached its duty to monitor the company as required under *Caremark*.[170] Because this claim attacks a failure to act, rather than a specific transaction, the *Rales* standard applies.[171] The *Rales* standard addresses whether the "board that would be addressing the demand can impartially consider its merits without being influenced by improper considerations."[172] To properly plead demand futility under *Rales*, a plaintiff must allege particularized facts which create a reasonable doubt that "the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand."[173]

"Under *Rales*, defendant directors who face a *substantial* likelihood of personal liability are deemed interested in the transaction and thus cannot make an impartial decision."[174] A simple allegation of potential directorial liability is insufficient to excuse demand, else the demand requirement itself would be rendered toothless, and directorial control over corporate litigation would be lost. The likelihood of directors' liability is significantly lessened

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[170] *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).
[171] *In re Dow Chem. Co. Derivative Litig.*, 2010 WL 66769, at *12 (Del. Ch. Jan. 11, 2010).
[172] *Rales*, 634 A.2d at 934.
[173] *Id.*
[174] *In re Dow Chem. Co. Derivative Litig.*, 2010 WL 66769, at *12 (internal quotations omitted; emphasis added); *Guttman v. Huang*, 823 A.2d 492, 501 (Del. Ch. 2003) ("[I]f the directors face a "substantial likelihood" of personal liability, their ability to consider a demand impartially is compromised under *Rales*, excusing demand.").

where, as here, the corporate charter exculpates the directors from liability to the extent authorized by 8 *Del. C.* § 102(b)(7).[175] Because Goldman's charter contains such a provision, shielding directors from liability for breaches of the duty of care (absent bad faith) "a serious threat of liability may only be found to exist if the plaintiff pleads a *non-exculpated* claim against the directors based on particularized facts."[176] This means that "plaintiffs must plead particularized facts showing bad faith in order to establish a substantial likelihood of personal directorial liability."[177]

The Plaintiffs' contentions that the Director Defendants face a substantial likelihood of personal liability are based on oversight liability, as articulated by then-Chancellor Allen in *Caremark.* In *Caremark,* Chancellor Allen held that a company's board of directors could not "satisfy [its] obligation to be reasonably informed . . . without assuring [itself] that information and reporting systems exist[ed] in the organization."[178] These systems are needed to provide the board with accurate information so that the board may reach "informed judgments concerning both the corporation's compliance with law and its business performance."[179] A breach of

[175] *Guttman*, 823 A.2d at 501.
[176] *Id.*
[177] *In re Dow Chem. Co. Derivative Litig.*, 2010 WL 66769, at *12; *see also Citigroup*, 964 A.2d at 124-25.
[178] *Caremark*, 698 A.2d at 970.
[179] *Id.*

oversight responsabilities is a breach of the duty of loyalty, and thus not exculpated under section 102(b)(7).

To face a substantial likelihood of oversight liability for a *Caremark* claim, the Director Defendants must have "(a) . . . utterly failed to implement any reporting or information system or controls" (which the Plaintiffs concede is not the case here); "*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."[180] Furthermore, "where a claim of directorial liability for corporate loss is predicated upon ignorance of liability creating activities within the corporation . . . only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system [exists] —will establish the lack of good faith that is a necessary condition to liability."[181]

The Plaintiffs specifically contend that the Director Defendants created a compensation structure that caused management's interests to diverge from the stockholders' interests. As a result, management took risks which eventually led to unethical behavior and illegal conduct that exposed

[180] *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).
[181] *Caremark*, 698 A.2d at 971; *see also Stone*, 911 A.2d at 370 ("Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith.").

Goldman to financial liability. According to the Plaintiffs, after the Director Defendants created Goldman's compensation structure, they had a duty to ensure protection from abuses by management, which were allegedly made more likely due to the form of that structure. Instead of overseeing management, however, the Director Defendants abdicated their oversight responsibilities.[182]

Unlike the original and most subsequent *Caremark* claims, where plaintiffs alleged that liability was predicated on a failure to oversee corporate conduct leading to violations of law,[183] the Plaintiffs here argue that the Director Defendants are also liable for oversight failure relating to

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[182] The Plaintiffs argue that under the facts pled here, I should impose an oversight requirement *higher* than that required by the standard *Caremark* analysis. At oral argument the Plaintiffs asserted that *Forsythe v. ESC Fund Mgmt. Co. (U.S.), Inc.*, 2007 WL 2982247 (Del. Ch. Oct. 9, 2007), calls for a heightened level of oversight by directors when management's incentives are not aligned with those of the shareholders. In *Forsythe*, the Court addressed whether a *partnership's* general partner violated its oversight duty to the partnership. The *Forsythe* Court decided that the language of the partnership agreement, rather than the common law, provided the proper standard of liability, but it also noted that a *Caremark* analysis would be not applicable because "*Caremark* rests importantly on the observation that corporate boards sit atop command-style management structures in which those to whom management duties are delegated generally owe their loyalty to the corporation," a structure unlike that in the *Forsythe* partnership. 2007 WL 2982247, at *7. Instead, *Forsythe* involved a "nominally independent general partner" that had "delegated nearly all of its managerial responsibilities to conflicted entities who acted through persons employed by and loyal to a third party." *Id*. The holding in *Forsythe* is, therefore, by its own terms not applicable to directors in a hierarchical corporation.

[183] *See Stone*, 911 A.2d 362 (failure to monitor violations of the Bank Secrecy Act); *In re Am. Int'l Group, Inc.*, 965 A.2d 763 (Del Ch. 2009) (failure to monitor illegal and fraudulent transactions); *David B. Shaev Profit Sharing Account v. Armstrong*, 2006 WL 391931 (Del. Ch. Feb. 13, 2006) (failure to monitor fraudulent business practices); *Caremark*, 698 A.2d 959 (failure to monitor violations of the Anti-Referral Payments Law).

Goldman's business performance.[184] Because the oversight of legal compliance and the oversight of business risk raise distinct concerns, I shall examine those issues separately.

1. Unlawful Conduct

As described above, the Plaintiffs must plead particularized facts suggesting that the board failed to implement a monitoring and reporting system or consciously disregarded the information provided by that system.[185] Here, the Plaintiffs assert that the Goldman employees engaged in unethical trading practices in search of short term revenues.[186] Although the Plaintiffs' allegations fall short of the florid contentions about the corporation made elsewhere,[187] the Plaintiffs provide examples, based on the Permanent Subcommittee report, of conduct they believe was unethical and harmful to the company.[188] The Plaintiffs argue that the Director Defendants should have been aware of purportedly unethical conduct such as securitizing high risk mortgages, shorting the mortgage market, using naked credit default swaps, and "magnifying risk" through the creation of synthetic

[184] *Cf. Citigroup*, 964 A.2d at 123 (dealing with a failure to monitor business risk).
[185] *Stone*, 911 A.2d at 370.
[186] Compl. ¶ 186.
[187] *See* Matt Taibbi, *The Great American Bubble Machine*, Rolling Stone Magazine, July 9-23, 2009, at 52 ("[Goldman] is a great vampire squid wrapped around the face of humanity, relentlessly jamming its blood funnel into anything that smells like money.").
[188] Compl. ¶¶ 147, 151.

CDOs.[189] The Plaintiffs also allege that Goldman's trading business often put Goldman in potential conflicts of interest with its own clients and that the Director Defendants were aware of this and have embraced this goal.

Illegal corporate conduct is not loyal corporate conduct. "[A] fiduciary of a Delaware corporation cannot be loyal to a Delaware corporation by knowingly causing it to seek profit by violating the law."[190] The "unethical" conduct the Plaintiffs allege here, however, is not the type of wrongdoing envisioned by *Caremark*. The conduct at issue here involves, for the most part, *legal* business decisions that were firmly within management's judgment to pursue. There is nothing intrinsic in using naked credit default swaps or shorting the mortgage market that makes these actions illegal or wrongful. These are actions that Goldman managers, presumably using their informed business judgment, made to hedge the Corporation's assets against risk or to earn a higher return. Legal, if risky, actions that are within management's discretion to pursue are not "red flags" that would put a board on notice of unlawful conduct.

Similarly, securitizing and selling high risk mortgages is not illegal or wrongful per se. The Plaintiffs take issue with actions where Goldman continued to sell mortgage related products to its clients while profiting from

[189] Compl. ¶ 151.
[190] *In re Massey Energy*, 2011 WL 2176479 at *20 (Del. Ch. May 31, 2011).

the decline of the mortgage market. In particular, the Plaintiffs point to three transactions where Goldman took the short side of synthetic CDOs while simultaneously being long on the underlying reference assets, or sold a long position while being, itself, short.

The three transactions referenced by the Plaintiffs as "disloyal and unethical trading practices" are not sufficient pleadings of wrongdoing or illegality necessary to establish a *Caremark* claim—the only inferences that can be made are that Goldman had risky assets and that Goldman made a business decision, involving risk, to sell or hedge these assets. The Hudson Mezzanine 2006-1 and Anderson Mezzanine Funding 2007-1 were synthetic CDOs that referenced RMBS securities.[191] Timberwolf I was a "hybrid cash/synthetic CDO squared" where "a significant portion of the referenced assets were CDO securities."[192] Goldman structured all three securities and took short positions because it was trying to reduce its mortgage holdings.[193] All three securities eventually were downgraded, and the investors who had taken long positions lost money.[194] The fact that another party would make money from such a decline was obvious to those investors—inherent in the structure of a synthetic CDO is that another party is taking a short position.

[191] Compl. ¶ 75.
[192] *Id.*
[193] *Id.*
[194] *Id.*

The Plaintiffs' allegations can be boiled down to the fact that these three securities lost money when Goldman may have had a conflict of interest. Though these transactions involved risk, including a risk of damaging the company's reputation, these are not "red flags" that would give rise to an actionable *Caremark* claim—reputational risk exists in any business decision.

To act in bad faith, there must be scienter on the part of the defendant director.[195] The Plaintiffs argue that, as Goldman increased its proprietary trading, the Director Defendants were aware of the possible conflicts of interest and that the conflicts had to be addressed. [196] The three transactions referenced by the Plaintiffs do not indicate that the Director Defendants "acted inconsistent[ly] with [their] fiduciary duties [or], most importantly, that the director[s] *knew* [they were] so acting."[197] A conflict of interest may involve wrongdoing, but is not wrongdoing itself. An active management of conflicts of interest is not an abdication of oversight duties, and an inference cannot be made that the Director Defendants were acting in bad faith.

The Plaintiffs also posit the theory that the credit rating agencies were beholden to Goldman and that Goldman unduly influenced them to give

[195] *See generally In re Massey Energy*, 2011 WL 2176479, at *16.
[196] Compl. ¶ 52.
[197] *In re Massey Energy*, 2011 WL 2176479, at *22.

higher credit ratings to certain products. These allegations are purely conclusory. The complaint is silent as to any mechanism (other than that inherent in the relationship of a credit agency to a large financial player) by which Goldman coerced or colluded with the ratings agencies or (more to the point in a *Caremark* context) that the Director Defendants disregarded any such actions in bad faith.

The heart of the Plaintiffs' *Caremark* claim is in the allegation that Goldman's "trading practices have subjected the Firm to civil liability, via, inter alia, an SEC investigation and lawsuit."[198] Once the legal, permissible business decisions are removed, what the Plaintiffs are left with is a single transaction that Goldman settled with the SEC.

In 2007 Goldman designed a CDO, Abacus 2007-AC1, with input from the hedge fund founder John Paulson.[199] The Plaintiffs allege that Paulson helped select a set of mortgages that would collateralize the CDO and then took a short position, betting that the same mortgages would fall in value.[200] The Plaintiffs point out that meanwhile Goldman was selling long positions in the CDO without disclosing Paulson's role in selecting the

[198] Compl. ¶ 75.
[199] Compl. ¶ 65.
[200] *Id*.

underlying collateral or Paulson's short position.[201] The Plaintiffs allege that "Goldman's clients who took long positions in Abacus 2007-AC1 lost their entire $1 billion investment."[202] As a result, on April 16, 2010 the SEC charged Goldman and a Goldman Vice President with fraud for their roles in creating and marketing Abacus 2007-AC1.[203] On July, 14 2010, Goldman settled the case with the SEC.[204] As part of the settlement, Goldman agreed to disgorge its profits on the Abacus transaction, pay a large civil penalty, and evaluate various compliance programs.[205]

The Abacus transaction, with its disclosure problems, is unique. The complaint does not plead with factual particularity that the other highlighted transactions contain disclosure omissions similar to Abacus, and the Abacus transaction on its own cannot demonstrate the willful ignorance of "red flags" on the part of the Defendants that might lead to a reasonable apprehension of liability.[206] Though the Plaintiffs allege that the "Abacus deals are likely just the tip of the iceberg," conclusory statements are not

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[201] *Id.*
[202] Compl. ¶ 69.
[203] Compl. ¶ 72.
[204] Compl. ¶ 73.
[205] *Id.*
[206] *See Stone*, 911 A.2d at 373 (holding that in the absence of "red flags," courts assess bad faith of the board only in the context of actions to insure that a reasonable reporting system exists, and not by assessing adverse outcomes).

particularized pleadings.[207] The single Abacus transaction without more is insufficient to provide a reasonable inference of bad faith on the part of the Director Defendants.

2. Business Risk

Part of the Plaintiffs' *Caremark* claim stems from the Director Defendants' oversight of Goldman's business practices. As a preliminary matter, this Court has not definitively stated whether a board's *Caremark* duties include a duty to monitor business risk. In *Citigroup*, then-Chancellor Chandler posited that "it may be possible for a plaintiff to meet the burden under some set of facts."[208] Indeed, the *Caremark* court seemed to suggest the possibility of such a claim:

> [I]t would . . . be a mistake to conclude that . . . corporate boards may satisfy their obligation to be reasonably informed concerning the corporation without assuring themselves that information and reporting systems exist in the organization that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with law *and its business performance*.[209]

[207] Compl. ¶ 75.
[208] *Citigroup*, 964 A.2d at 126.
[209] *Caremark*, 698 A.2d at 970 (emphasis added).

As was the case in *Citigroup*, however, the facts pled here do not give rise to a claim under *Caremark*, and thus I do not need to reach the issue of whether the duty of oversight includes the duty to monitor business risk.

As the Court observed in *Citigroup*, "imposing *Caremark*-type duties on directors to monitor business risk is fundamentally different" from imposing on directors a duty to monitor fraud and illegal activity.[210] Risk is "the chance that a return on an investment will be different than expected."[211] Consistent with this, "a company or investor that is willing to take on more risk can earn a higher return."[212] The manner in which a company "evaluate[s] the trade-off between risk and return" is "[t]he essence of . . . business judgment."[213] The Plaintiffs here allege that Goldman was over-leveraged, engaged in risky business practices, and did not set enough money aside for future losses.[214] As a result, the Plaintiffs assert, Goldman was undercapitalized, forcing it to become a bank holding company and to take on an onerous loan from Warren Buffet.[215]

Although the Plaintiffs have molded their claims with an eye to the language of *Caremark*, the essence of their complaint is that I should hold

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[210] *Citigroup*, 964 A.2d at 131.
[211] *Id*. at 126.
[212] *Id*.
[213] *Id*.
[214] Compl. ¶ 131, *see* Compl. ¶¶ 93-141.
[215] Compl. ¶¶ 133-34.

the Director Defendants "personally liable for making (or allowing to be made) business decisions that, in hindsight, turned out poorly for the Company."[216] If an actionable duty to monitor business risk exists, it cannot encompass any substantive evaluation by a court of a board's determination of the appropriate amount of risk. Such decisions plainly involve business judgment.[217]

The Plaintiffs' remaining allegations in essence seek to hold the Director Defendants "personally liable to the Company because they failed to fully recognize the risk posed by subprime securities."[218] The Plaintiffs charge that the entire board was aware of, or should have been aware of, "the details of the trading business of Goldman and failed to take appropriate action."[219] The Plaintiffs note that "[a]s the housing market began to fracture

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[216] *Id*. at 124.

[217] While a valid claim against a board of directors in a hierarchical corporation for failure to monitor risk undertaken by corporate employees is a theoretical possibility, it would be, appropriately, a difficult cause of action on which to prevail. Assuming excessive risk-taking at some level becomes the misconduct contemplated by *Caremark*, the plaintiff would essentially have to show that the board *consciously* failed to implement any sort of risk monitoring system or, having implemented such a system, *consciously* disregarded red flags signaling that the company's employees were taking facially improper, and not just ex-post ill-advised or even bone-headed, business risks. Such bad-faith indifference would be formidably difficult to prove.

This heavy burden serves an important function in preserving the effectiveness of 8 *Del. C.* § 102(b)(7) exculpatory provisions. If plaintiffs could avoid the requirement of showing bad faith by twisting their duty of care claims into *Caremark* loyalty claims, such a scenario would eviscerate the purpose of 8 *Del. C.* § 102(b)(7) and could potentially chill the service of qualified directors.

[218] *Citigroup*, 964 A.2d at 124.

[219] Compl. ¶ 147.

in early 2007, a committee of senior Goldman executives . . . including Defendants Viniar, Cohn, and Blankfein and those helping to manage Goldman's mortgage, credit and legal operations, took an active role in overseeing the mortgage unit."[220] "[This] committee's job was to vet potential new products and transactions, being wary of deals that exposed Goldman to too much risk."[221] This committee eventually decided that housing prices would decline and decided to take a short position in the mortgage market.[222] The Plaintiffs contend that the Director Defendants were "fully aware of the extent of Goldman's RMBS and CDO securities market activities."[223] The Plaintiffs point out that the Director Defendants were informed about the business decisions Goldman made during the year including an "intensive effort to not only reduce its mortgage risk exposure, but profit from high risk RMBS and CDO Securities incurring losses."[224] The Plaintiffs further allege that because of this the Director Defendants "understood that these efforts involved very large amounts of Goldman's capital that exceeded the Company's Value-at-Risk measures."[225] Finally, the Plaintiffs allege that the practices allowed by the board, including

[220] Compl. ¶ 59.
[221] *Id.*
[222] Compl. ¶¶ 60-61.
[223] Compl. ¶ 147.
[224] Compl. ¶ 148.
[225] Compl. ¶ 149.

transactions in which Goldman's risk was hedged, imposed reputational risk upon the corporation.[226]

Thus, the Plaintiffs do not plead with particularity anything that suggests that the Director Defendants acted in bad faith or otherwise consciously disregarded their *oversight* responsibilities in regards to Goldman's business risk. Goldman had an Audit Committee in place that was "charged with assisting the Board in its oversight of the Company's management of market, credit liquidity and other financial and operational risks."[227] The Director Defendants exercised their business judgment in choosing and implementing a risk management system that they presumably believed would keep them reasonably informed of the company's business risks. As described in detail above, the Plaintiffs admit that the Director Defendants were "fully aware of the extent of Goldman's RMBS and CDO securities market activities."[228]

"Oversight duties under Delaware law are not designed to subject directors, even expert directors, to *personal liability* for failure to predict the future and to properly evaluate business risk."[229] No reasonable inference can be made from the pleadings that the Director Defendants consciously

[226] Compl. ¶¶ 64, 77, 84.
[227] Compl. ¶ 78 (internal quotations omitted).
[228] Compl. ¶ 147.
[229] *Citigroup*, 964 A.2d at 131.

disregarded their duty to be informed about business risk (assuming such a duty exists). On the contrary, the pleadings suggest that the Director Defendants kept themselves reasonably informed and fulfilled their duty of oversight in good faith.[230] Good faith, not a good result, is what is required of the board.

Goldman's board and management made decisions to hedge exposure during the deterioration of the housing market, decisions that have been roundly criticized in Congress and elsewhere. Those decisions involved taking objectively large risks, including particularly reputational risks. The outcome of that risk-taking may prove ultimately costly to the corporation. The Plaintiffs, however, have failed to plead with particularity that the Director Defendants consciously and in bad faith disregarded these risks; to the contrary, the facts pled indicate that the board kept itself informed of the risks involved. The Plaintiffs have failed to plead facts showing a substantial likelihood of liability on the part of the Director Defendants under *Caremark.*

IV. CONCLUSION

The Delaware General Corporation law affords directors and officers broad discretion to exercise their business judgment in the fulfillment of

[230] *Id*. at 126.

their obligations to the corporation. Consequently, Delaware's case law imposes fiduciary duties on directors and officers to ensure their loyalty and care toward the corporation. When an individual breaches these duties, it is the proper function of this Court to step in and enforce those fiduciary obligations.

Here, the Plaintiffs allege that the Director Defendants violated fiduciary duties in setting compensation levels and failing to oversee the risks created thereby. The facts pled in support of these allegations, however, if true, support only a conclusion that the directors made poor business decisions. Through the business judgment rule, Delaware law encourages corporate fiduciaries to attempt to increase stockholder wealth by engaging in those risks that, in their business judgment, are in the best interest of the corporation "without the debilitating fear that they will be held personally liable if the company experiences losses."[231] The Plaintiffs have failed to allege facts sufficient to demonstrate that the directors were unable to properly exercise this judgment in deciding whether to bring these claims. Since the Plaintiffs have failed to make a demand upon the Corporation, this matter must be dismissed; therefore, I need not reach the Defendant's motion to dismiss under Rule 12 (b)(6).

[231] *Citigroup*, 964 A.2d at 139.

For the foregoing reasons, the Defendants' motion to dismiss is granted, and the Plaintiffs' claims are dismissed with prejudice.

An Order has been entered consistent with this Opinion.