

**COURT OF CHANCERY  
OF THE  
STATE OF DELAWARE**

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COURT OF CHANCERY COURTHOUSE  
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GEORGETOWN, DELAWARE 19947

Submitted: January 17, 2006

Decided: January 26, 2006

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Re: *Stone, et al. v. Ritter, et al.*  
Civil Action No. 1570-N

Dear Counsel:

Plaintiffs attempt to bring a derivative action on behalf of AmSouth Bancorporation (“AmSouth”), alleging that fifteen defendants—all current or former AmSouth directors—breached their fiduciary duties by failing to institute sufficient internal controls to guard against violations of the Bank Secrecy Act and anti-money laundering regulations. The Court heard argument on January 24, 2006, on the defendants’ motion to dismiss the complaint. The defendants contend the pleading fails to satisfy the demand

requirements of Court of Chancery Rule 23.1. At the conclusion of the hearing, the Court announced that the motion would be granted. This letter briefly summarizes the reasons for that decision.

On numerous previous occasions, this Court and the Delaware Supreme Court have urged would-be derivative plaintiffs to use the so-called “tools at hand” before filing complaints.<sup>1</sup> As Vice-Chancellor Lamb stated in *In re Citigroup*, the “purpose of such investigation is to enable [derivative plaintiffs] to draw complaints that satisfy Rule 23.1’s requirement that facts be alleged ‘with particularity’ justifying demand excusal.”<sup>2</sup> Plaintiffs in this case conducted a search of AmSouth’s books and records, but their search failed to turn up any useful facts supporting their allegation that demand should be excused. Accordingly, the fact that plaintiffs made use of the “tools at hand” does not influence my decision.

The troubles for AmSouth began as early as August of 2000, when an AmSouth branch office agreed to perform custodial duties on accounts opened by two bank customers who were later convicted of running a “ponzi” scheme.”<sup>3</sup> These two individuals—Louis D. Hamric and Victor G. Nance (“Hamric and Nance”)—misrepresented to AmSouth that their

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<sup>1</sup> See, e.g., *In re Citigroup S’holders Litig.*, 2003 WL 21384599 (Del. Ch. June 5, 2003); see also *Rales v. Blasband*, 634 A.2d 927, 934-35, n.10 (Del. 1993).

<sup>2</sup> *In re Citigroup*, 2003 WL 21384599, at \*1

<sup>3</sup> Compl. ¶ 49.

business venture involved construction of medical clinics overseas.<sup>4</sup> When the ponzi scheme eventually collapsed, Hamric and Nance became the subject of investigations by state and federal authorities.<sup>5</sup> In addition, federal authorities began an investigation of AmSouth's compliance with the Bank Secrecy Act and other anti-money laundering regulations. Those regulations require, among other things, the filing of Suspicious Activity Reports ("SARs") when a bank employee has reason to suspect the bank's services are being used for illegal activities.<sup>6</sup>

Plaintiffs rely extensively on the findings contained in a government report prepared by the United States Department of Treasury, Financial Crimes Enforcement Network ("FinCEN").<sup>7</sup> The FinCEN report determined that AmSouth employees did not file SARs in circumstances where they should have. Additionally, the report concluded that

AmSouth failed to develop an anti-money laundering program tailored to the risks of its business and reasonably designed, as required by law, to prevent the Bank from being used to launder money.... AmSouth's program lacked adequate board and management oversight.... The result was a fragmented program in which areas of the Bank had information on suspicious activity that was never communicated to those responsible for Bank Secrecy Act compliance."<sup>8</sup>

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<sup>4</sup> *Id.*

<sup>5</sup> *Id.* at ¶ 53.

<sup>6</sup> *Id.* at ¶ 41.

<sup>7</sup> Compl. Ex. E

<sup>8</sup> *Id.* at 2.

Plaintiffs' complaint restates these conclusions—particularly the one with regard to a lack of oversight—but fails to plead *with particularity* the facts underlying the FinCEN report's conclusions. Without these facts, plaintiffs' statements taken from the FinCEN report are simply conclusory.

Before they may proceed with their derivative claim, under Rule 23.1 plaintiffs must plead with particularity the reasons why pre-suit demand would have been futile. The test for demand futility is a two-pronged test. Demand is excused if: (1) there is a reasonable doubt the directors were disinterested and independent, or (2) the pleading creates a reasonable doubt that the challenged transaction was “otherwise the product of a valid business judgment.”<sup>9</sup> Plaintiffs argue that, under both prongs, their failure to make demand should be excused.

First, plaintiffs contend that the board was not disinterested and independent because the defendants “face a substantial likelihood of liability” for their failure to implement adequate internal controls.<sup>10</sup> Plaintiffs' complaint is devoid of the particularized allegations of fact needed to tie the defendants to any of the alleged wrongdoing. Plaintiffs fail to point to any facts either showing how the Hamric and Nance scheme, or

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<sup>9</sup> *Brehm v. Eisner*, 746 A.2d 244, 256 (Del. 2000).

<sup>10</sup> Pls.' Answering Br. at 25. Nothing in the complaint suggests any of the defendants were self-interested in the sense of receiving a personal benefit from their alleged failure to institute adequate internal controls.

any other problems at AmSouth, waved a “red-flag” in the face of the board. Nor do plaintiffs point to facts suggesting a conscious decision to take no action in response to red flags. Without these well-pled allegations, there is no possibility the defendants faced a substantial likelihood of liability.

Second, plaintiffs contend that demand is excused because, under the second prong, the directors made no business judgment with regard to internal controls, but instead “consciously and intentionally disregarded their responsibilities after the Hamric-Nance scheme highlighted deficiencies with AmSouth’s BSA/AML compliance program.”<sup>11</sup> According to plaintiffs, demand is excused because the board “failed to exercise *any* business judgment and failed to make any good faith attempt to fulfill [the directors’] fiduciary duties.”<sup>12</sup> Plaintiffs assert, citing this Court’s recent *Disney* decision,<sup>13</sup> that the defendants adopted “in effect, a ‘we don’t care about the risks’ attitude concerning a material corporate decision.”<sup>14</sup> These conclusory allegations, without supporting facts, do nothing to suggest that demand should be excused. This case is not about a board’s failure to carefully consider a material corporate decision that was presented to the board. This is a case where information was not reaching the board because of

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<sup>11</sup> Pls.’ Answering Br. at 23.

<sup>12</sup> *Id.* at 24.

<sup>13</sup> *In re Walt Disney Co. Derivative Litig.*, 2005 WL 2056651 (Del. Ch. Aug. 2005).

<sup>14</sup> *Id.* at 25.

ineffective internal controls. Plaintiffs have not pled any facts showing that the board ever was aware that AmSouth's internal controls were inadequate, that these inadequacies would result in illegal activity, and that the board chose to do nothing about problems it allegedly knew existed.

With the benefit of hindsight, it is beyond question that Amsouth's internal controls with respect to the Bank Secrecy Act and anti-money laundering regulations compliance were inadequate. Neither party disputes that the lack of internal controls resulted in a huge fine—\$50 million, alleged to be the largest ever of its kind. The fact of those losses, however, is not alone enough for a court to conclude that a majority of the corporation's board of directors is disqualified from considering demand that AmSouth bring suit against those responsible. The complaint completely fails to set forth adequate reasons why demand is excused.

For the foregoing reasons, the complaint is dismissed. In accordance with Rule 15(aaa), the dismissal will be with prejudice.

Very truly yours,

A handwritten signature in cursive script that reads "William B. Chandler III". The signature is written in black ink and includes a horizontal line at the end.

William B. Chandler III

WBCIII:wbg