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SUPERIOR COURT OF THE STATE OF CALIFORNIA

IN AND FOR THE CITY AND COUNTY OF SAN FRANCISCO

IN RE WELLS FARGO & COMPANY DERIVATIVE LITIGATION This Document Relates To: ALL ACTIONS.	Lead Case No.: CGC 16-554407 **PLAINTIFFS' MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO DEFENDANTS' DEMURRERS** **Date:** May 9, 2017 **Time:** 9:00 a.m. **Dept.:** 304 **Judge:** Hon. Curtis E.A. Karnow

1
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7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

TABLE OF CONTENTS

Page

I. INTRODUCTION 1

II. STATEMENT OF FACTS 5

A. ROLES AND RESPONSIBILITIES OF THE DIRECTOR DEFENDANTS 5

B. ROLES AND RESPONSIBILITIES OF THE OFFICER DEFENDANTS 8

C. "CROSS-SELLING" WAS INTEGRAL TO WELLS FARGO'S BUSINESS, AND PRESSURE ON EMPLOYEES TO CHEAT TO MEET IMPOSSIBLE STANDARDS WAS WELL KNOWN 11

D. REGULATOR INVESTIGATIONS AND CUSTOMER AND EMPLOYEE COMPLAINTS ALERTED DEFENDANTS TO THE WRONGFUL CONDUCT 13

E. NUMEROUS, OBVIOUS RED FLAGS WERE AVAILABLE TO THE BOARD 17

F. THE TRUTH CONTINUES TO UNFOLD: ADDITIONAL REVELATIONS OF SALES ABUSES AFTER THE COMPLAINT WAS FILED, ADDITIONAL DAMAGES TO COMPANY 20

III. ARGUMENT 22

A. PLAINTIFFS ADEQUATELY ALLEGED DEMAND FUTILITY 22

1. Legal Standard for Demand Futility 22

2. Defendants' Characterization of Plaintiffs' Claims Is Irrelevant 24

3. Demand is Futile Because A Majority of Board Members Face a Substantial Likelihood of Liability 25

4. Demand is Excused Because A Majority of Defendants Lack Independence or Have an Interest in Defending the Misconduct 30

B. WELLS FARGO'S EXCULPATORY CLAUSE DOES NOT IMPACT PLAINTIFFS' CLAIMS, NOR THE DEMAND FUTILITY ANALYSIS 33

C. BREACH OF FIDUCIARY DUTY IS ADEQUATELY ALLEGED 34

D. ABUSE OF CONTROL AND GROSS MISMANAGEMENT ARE ADEQUATELY ALLEGED 38

E. UNJUST ENRICHMENT IS ADEQUATELY ALLEGED 38

F. CORPORATE WASTE IS ADEQUATELY ALLEGED 40

G. VIOLATION OF CALIFORNIA CORPORATION CODE SECTION 25402 FOR INSIDER SELLING IS ADEQUATELY ALLEGED 42

IV. CONCLUSION 44

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

TABLE OF AUTHORITIES

Page(s)

Cases

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(Del. Super. Sept. 15, 2004) 2004 WL 2050527 38

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(Nov. 6, 2002) 2002 Del. Ch. LEXIS 156 33

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(Del. 1984) 473 A.2d 805 .... 22, 23, 30

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(Del Ch. Dec. 21, 2006) 2006 WL 3783520 28

Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart
(Del. 2004) 845 A.2d 1040 30

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(Del. Ch. 1928) 453 A.2d 467 23

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(Del. 2000) 746 A.2d 244 23

Calma on Behalf of Citrix Sys., Inc. v. Templeton
(Del. Ch. 2015) 114 A.3d 563 39

Charter Twp. Of Clinton Police & Fire Ret. Sys. v. Martin
(2013) 219 Cal.App.4th 924 22

Collins & Aikman Corp. v. Stockman
(D. Del. May 20, 2009) 2009 U.S. Dist. LEXIS 43472 33

Compare with In re Massey Energy Co.
(Del. Ch. May 31, 2011) No. CIV.A. 5430-VCS, 2011 WL 2176479 36

County of San Bernardino v. Walsh
(2007) 158 Cal.App.4th 533 40

Del. Cty. Emples. Ret. Fund v. Sanchez
(Del. 2015) 124 A.3d 1017 23

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(Del. Ch. Oct. 28, 2011) 2011 WL 5137175 39

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(Del. 1999) 726 A.2d 1215 33

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(Del. Ch. 2015) 124 A.3d 47........ 39

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(Del. 1988) 539 A.2d 1060 39

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(Del. Ch. Mar. 10, 2014) 2014 WL 957550........ 39

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(Del. 2013) 58 A.3d 414 41

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(2005) 134 Cal.App.4th 693 .... 4, 42

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(1996) 14 Cal.4th 39 39

Guttman v. Jen-Hsun Huang
(Del. Ch. 2003) 823 A.2d 492........ 25

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(D. Del. 2013) 966 F.Supp.2d 406........ 41

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(7th Cir. 2003) 325 F.3d 795 .... 24, 28

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(Del. Ch. 2009) 976 A.2d 872........ 25, 35, 37

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(N.D. Cal. Dec. 15, 2008) 2008 WL 523264........ 34

In re Caremark Int'l Inc. Derivative Litig.
(Del Ch. 1996) 698 A.2d 967........ 24, 35

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(Del. Ch. 2009) 964 A.2d 106........ 38

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(C.D. Cal. 2008) 554 F. Supp. 2d 1044 .... 29, 30, 35

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No. 9962-VCL, 2016 WL 301245 (Del. Ch. Jan. 25, 2016)........ 24

In re Finisar Corp. Deriv. Litig.
(N.D. Cal. July 12, 2012) 2012 WL 2873844 .... 4, 42

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953 A.2d 963 (Del. Ch. 2007) 23

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(Del. Ch. 2008) 967 A.2d 640 34

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(S.D.N.Y. 2000) 192 F.R.D. 111 23

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(N.D. Cal. 2003) 278 F.Supp.2d 1079 42

In re Tower Air, Inc.
(3d Cir. 2005) 416 F.3d 229 34

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(S.D.N.Y. 2006) 434 F.Supp.2d 267 .... 33, 36

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(N.D. Cal. May 26, 2009) 2009 WL 1458233 34

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(N.D. Cal. 2007) 531 F.Supp.2d 1173 42

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(Del. 2006) 906 A.2d 27 25

KBC Asset Mgmt. NV v. McNamara
(D. Del. May 12, 2016) 2016 WL 2758256 28

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(2000) 77 Cal.App.4th 723 39

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(Del. 1991) 591 A.2d 194 23

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(2012) 206 Cal.App.4th 351 42

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(Del. Ch. 2012) 46 A.3d 313 24

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(Del. 2001) 780 A.2d 1075 34

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(Del. Ch. 2004) 854 A.2d 121 38

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(Del. Ch. 1999) 745 A.2d 902 34

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(2008) 164 Cal.App.4th 1583 39

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(Del. 2013) 74 A.3d 612 24

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(Del. 1993) 634 A.2d 927 .... 23, 24, 30, 33

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(Del. Ch. Oct. 18, 2016) 2016 WL 6081823 28

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(9th Cir. 2014) 765 F.3d 1137 .... 25, 26

Ryan v. Gifford
(Del. Ch. 2007) 918 A.2d 341 39

Sanders v. Wang
(Del. Ch. Nov. 8, 1999) 1999 WL 1044880 34

Schock v. Nash
(Del. 1999) 732 A.2d 217 39

Stone ex rel. AmSouth Bancorporation v. Ritter ("*Stone*")
(Del. 2006) 911 A.2d 362 .... 25, 26

Stone v. Ritter
(Del. 2006) 911 A.2d 362 34

Swingless Golf Club Corp. v. Taylor
(N.D. Cal. 2009) 679 F.Supp.2d 1060 40

Teachers' Ret. Sys. of Louisiana v. Gen. Re Corp.
(Del. 2010) 11 A.3d 228 25

Weiss v. Swanson
(Del. Ch. 2008) 948 A.2d 433 41

White v. Panic
(Del. 2001) 783 A.2d 543 40

1
2
3
4
5
6
7
8
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10
11
12
13
14
15
16
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18
19
20
21
22
23
24
25
26
27
28

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9 Witkin, Summary of Cal. Law
Corporations 239, § 1006 (10th ed. 2005) 42

Rules

Cal. Corp. Code § 800(b)(2) 22

Cal. Corp. Code § 25402.. 4, 42

Delaware General Corporations Law section 102(b)(7).. 33

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
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I. INTRODUCTION

This shareholder derivative action is based on a corporate governance breakdown of epic proportions. For ***over a decade***, under the supposed watch of the officers and directors of Wells Fargo & Company ("Wells Fargo," the "Bank", or the "Company"), ***thousands*** of Bank employees created ***millions*** of fake accounts in order to meet unrealistic sales goals, and thereby fleeced the Bank's own customers. While Bank customers were unaware of the fraud as they were being victimized, the illegal sales practices were open, notorious and pervasive at Wells Fargo, premised on incentive policies that applied to every Bank employee, in every branch, in every state.

Unfortunately for Wells Fargo, its shareholders, and its customers, the Company's Board of Directors (the "Board") chose to act as the lap dog, rather than the watch dog, of senior management, and repeatedly turned a blind eye to obvious "red flag" warnings of illegal conduct – warnings from every direction, including from employees, customers, regulators, and even third-party lawsuits. Predictably, without any check from the top, the illegal sales practices only grew worse over time. On September 8, 2016, after a decade of Board inaction, and unwilling to wait any longer for oversight, federal regulators stepped in and imposed Consent Orders requiring the Bank to reimburse customers, pay fines, and reform the Bank's risk management and oversight function.

Subsequent Congressional testimony only further exposed the systemic breakdown in corporate governance at Wells Fargo. The Board's utter failure to implement, monitor and enforce basic systems of internal controls over its sales practices and risk management, and compensation programs approved by the Company's senior management, ultimately incentivized illegal behavior impacting *2 million accounts* and the termination of over *5,000 employees*. In Senate testimony, regulators decried the Board's failure of oversight. Customer class actions were filed, settled, and re-negotiated again, as new details emerged about the scope of the fraud.

Wells Fargo is now a pariah, as retail and institutional shareholders alike protest at its annual meeting. Once loyal customers, including entire cities and states, now refuse to do business with the Bank. The famed Wells Fargo Stagecoach, long held out as a symbol of the Bank's

1 "heritage of service, stability, and innovation," is now viewed as a symbol of Board dysfunction
2 and greed.
3 While this conduct and the resulting harm is detailed in the Complaint and attachments,
4 each of the Defendants[1] filed demurrers and challenged various aspects of the Complaint. As
5 discussed below, the demurrers should be overruled.
6 **Wells Fargo Demurrer: Demand Futility**
7 Wells Fargo asserts that Plaintiffs should have made a pre-suit demand on the Board to
8 evaluate their claims and have not sufficiently alleged why a pre-suit demand would have been
9 futile. The argument strains credulity.
10 To adequately allege "demand futility," Plaintiffs only needed to allege sufficient facts
11 which, if ***presumed to be true*** and with ***all inferences drawn in Plaintiffs' favor***, create at least a
12 "***reasonable doubt***" that a majority of Wells Fargo's 15-member Board was capable of evaluating
13 claims with independence and disinterest. Here, Plaintiffs' Complaint, including a 15-page section
14 specifically devoted to "demand futility" allegations, as well as attached Consent Orders and
15 testimony, detail for each Director Defendant why demand would be futile. The allegations
16 demonstrate why each Director Defendant faces a substantial risk of personal exposure for his or
17 her actions or inaction (again, assuming the allegations are true and established at trial). The
18 allegations describe why each Director Defendant, in their capacities as members of the Board and
19 ***key Board Committees charged with oversight of customer sales practices, employee***
20 ***terminations, and related risk management issues***, disregarded reports and other red flags and
21 failed to monitor and stop the illegal practices, in breach of their fiduciary duties. They now face
22 personal liability in this case for conduct that Wells Fargo's own regulators have found deficient.
23 Curiously, Wells Fargo's brief appears to ask the Court to consider the "context" of red
24 flags made available to the Board, and then questions whether, given its large size, reports of
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[1] As defined in the Complaint and used herein, "Director Defendants" refers to Defendants who served on Wells Fargo's Board of Directors. "Officer Defendants" refers to executive officers John Stumpf, Timothy Sloan, Carrie Tolstedt, and John Shrewsberry. "Individual Defendants" refers collectively to the Director Defendants and Officer Defendants, and "Defendants" refers to all Defendants, including Wells Fargo.

rampant sales fraud and thousands of terminated employees are "true red flags or the sort of thing that can happen any (or even every) day in an organization as vast as Wells Fargo." WF at 2. Not surprisingly, Wells Fargo doesn't answer its own question. This "too big to govern" argument is not only offensive to Bank customers and shareholders, but contrary to core Delaware and California principles that require that directors take action to address wrongdoing. Directors have an affirmative duty to act if they are on notice of red flags, and to prevent problems from escalating. Here, they did not.

Demand is properly alleged to be "futile" in this case.

Individual Defendants: Failure to State Claim/Specificity

The Individual Defendants separately demurred to some or all of Plaintiffs' causes of action.

First, the Officer Defendants (but not the Director Defendants) demurred to the Breach of Fiduciary Duty cause of action. Contrary to the Officer Defendants' arguments, the Complaint adequately states claims for relief against these four officers – the highest ranking senior management at Wells Fargo, during the time of the subject sales abuses – based on their breaches of the fiduciary duties of care, good faith, ***and*** loyalty. The Officer Defendants focus on the breach of loyalty claims, and make much of Plaintiffs' "oversight" theory of liability and the presumed difficulty proving that officers breached duties of loyalty by failing to implement reporting controls or, having implemented them, failing to inform themselves of risks requiring their attention. Yet, ***that is exactly what this case is about*** (and what the Consent Orders explicitly determined). The Complaint also alleges breach of care claims based on the Officer Defendants' failure to manage the Company consistent with their fiduciary duties, concealing the sales practices from the public, and enriching themselves through compensation packages (and insider trading proceeds) to which they were not entitled. Both theories are inherently fact-intensive inquiries and inappropriate for resolution on demurrer. Similarly, Defendants' demurrers to the Abuse of Control and Gross Mismanagement causes of action – solely on the basis that they duplicate the Breach of Fiduciary Duty claim – should be overruled. Delaware courts permit a plaintiff to pursue these theories.

All Individual Defendants demur to the cause of action for Unjust Enrichment, and the Director Defendants demur to the cause of action for Corporate Waste. Both claims are valid under Delaware law, and premised on receipt of compensation packages (and for Corporate Waste, approval of golden parachutes and compensation packages for Stumpf and Tolstedt) without justification to the Corporation and based on inflated, illegal sales performance metrics.

Finally, the Officer Defendants demurrer to Plaintiffs' cause of action for violation of California Corporation Code Section 25402, California's unique insider trading statute which explicitly gives standing to shareholders suing on behalf of issuers. Shrewsberry and Sloan assert that the "internal affairs" doctrine mandates that Plaintiffs pursue their claims under Delaware (and not California) law, conveniently omitting the seminal California case that rejected that same argument. *Friese v. Superior Court* (2005) 134 Cal.App.4th 693, 708. Alternatively, Defendants assert that if Plaintiffs' Section 25402 is based on fraud it must be pled with particularity. However, this is not a fraud claim; indeed, there is no intent element at all. To state a claim, a plaintiff need only allege a defendant purchased or sold shares while he or she had knowledge of material, non-public information. *See In re Finisar Corp. Deriv. Litig.* (N.D. Cal. July 12, 2012) 2012 WL 2873844, at *20-21. In any event, Plaintiffs did plead the elements of Section 25402 with particularity, including each Officer Defendants' knowledge and access to material, non-public information at the time of each trade.

II. STATEMENT OF FACTS[2]

A. Roles and Responsibilities of the Director Defendants

Wells Fargo's Board adopted written Corporate Governance Guidelines to provide the framework for governance of the Board and the Company. ¶ 202.[3] The guidelines provide that "[t]he business of the Company is managed under the direction of its Board." Among other things, the Board's oversight responsibilities include: "ensuring processes are in place for maintaining the integrity and reputation of the Company and reinforcing a culture of ethics, compliance and risk management." ¶ 202.[4]

According to Wells Fargo's U.S. Securities and Exchange Commission ("SEC") filings, the entire Board was delegated responsibility for the Bank's overall enterprise risk appetite. In addition, at least four Board Committees are significantly implicated in the wrongdoing and the

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[2] As described in the Statement of Facts, Plaintiffs' Complaint details the scope of the illegal sales practices, the respective roles of the Individual Defendants, and their positions and ability to consider and act on "red flags" over time. The allegations are supported by documents attached to the Complaint, including Consent Orders issued by Wells Fargo's regulator, the Office of the Comptroller of the Currency ("OCC"), and the Consumer Financial Protection Bureau ("CFPB").

In its demurrer, Wells Fargo challenges the "context" of Plaintiffs' allegations, suggesting that individual events or reports of misconduct may not have been a "true red flag" and instead may have been "the sort of thing that can happen any (or even every) day in an organization as vast as Wells Fargo." Plaintiffs agree that context is important, and submits that the Complaint's allegations (and inferences drawn in Plaintiffs' favor) adequately support allegations of notice, knowledge and bad faith. To the extent further "context" is required, Plaintiffs also ask the Court to take judicial notice of certain additional evidence discovered ***after*** the Complaint was filed. This evidence relates to allegations in the Complaint, including admissions made in the "Sales Practices Investigation Report" issued by Wells Fargo's own "Independent Directors" on April 10, 2017, and findings in the "Lessons Learned Review of Supervision of Sales Practices at Wells Fargo," issued by the OCC's Office of Enterprise Governance on April 19, 2017. Plaintiffs also obtained declarations from former Bank customers and employees detailing the underlying sales practices and the extraordinary harm it has wreaked on their lives. This evidence provides some additional "context" for the allegations, as requested by Wells Fargo.

[3] All paragraph references refer to the Consolidated Shareholder Derivative Complaint ("Complaint") unless otherwise indicated.

[4] Wells Fargo is a bank holding company, formed as a Delaware corporation, with its headquarters and principal place of business in San Francisco, California. ¶ 40. The Company's principal business is to act as a holding company for its subsidiaries, including Wells Fargo Bank, N.A., the principal subsidiary of the Company, with assets of $1.6 trillion, or 90% of the Company's total assets. *Id.*

breakdown of risk oversight: the Risk Committee, the Corporate Responsibility Committee, the Audit and Examination Committee, and the Human Resources Committee. Members of these key Board Committees utterly failed to exercise their fiduciary duties and follow the Committees' respective charters.

The Risk Committee was created in 2011, and tasked with overall management of the Bank's risk management. The Committee was charged with oversight of the Corporate Risk function and performance of the Chief Risk Officer, who in turn chaired the Enterprise Risk Management Committee – a management level committee which served as the focal point for risk governance and oversight, and which reported to the Risk Committee.

The Risk Committee's Charter stated that its purpose is to, among other things: (1) "provide oversight of [the Company's] enterprise-wide risk management framework and corporate risk function, including the strategies, policies, procedures, processes, and systems, established by management to identify, assess, measure, monitor, and manage the major risks facing the Wells Fargo & Company;" and (2) "assist the Board of Directors and its other committees that oversee specific risk-related issues and serve as a resource to management by overseeing risk across the entire Company and across all risk types, and by enhancing management's and the Board's understanding of [the Company's] overall risk appetite and enterprise-wide risk management activities and effectiveness." ¶ 219.

The Charter for the Corporate Responsibility Committee stated that its risk oversight function covered, among other things:

> "monitor[ing] [the Company's] reputation generally, including with customers," which includes receiving and reviewing updates from management on: . . . ***customer service and complaint matters and other metrics relating to the Company's brand and reputation, including matters relating to the Company's culture and the focus of its team members on serving our customers***.

¶ 212.

The Charter for the Audit and Examination Committee states that its risk oversight function covered, among other things, operational and reputation risk stemming from ***the Company's compliance with legal and regulatory requirements, ethics, and business conduct***. ¶ 210.

The Charter for the Human Resources Committee stated that its oversight function covered, among other things, ***overall incentive compensation strategy, incentive compensation practices, and compensation risk management***. ¶ 217.

The Director Defendants were reportedly paid significant sums for their service on the Board and Board Committees, summarized as follows:

Non-Officer Director Defendant[5]	**Audit & Examination Committee**	**Corporate Responsibility Committee**	**Governance & Nominating Committee**	**Human Resources Committee**	**Risk Committee**	**2015 Compensation**
Baker (Since 2009)	2011-2016	2011-2016				Over $361,000 (¶¶ 229-231)
Chao (2011-1/2017)		2011				Over $291,000 (¶¶ 232)
Chen (Since 2006)				2011-2016		Over $279,000 (¶¶ 233-234)
Dean (Since 2005)		2011-2016	2012-2016	2011-2016 (2011-2016)*	2011-2016	Over $346,000 (¶¶ 235-239)
Duke (Since 2015)					2014-2016	Over $354,000 (¶¶ 240-241)
Engel (Since 1998)				2011-2016		Over $331,000 (¶¶ 242-243)
Hernandez (Since 2003)	2011-2014	2011-2016			2011-2016 (2011-2016)*	Over $402,000 (¶¶ 244-246)
James (Since 2009)				2011-2016		Over $293,000 (¶¶ 247-248)

[5] The time period listed in this column reflects Board membership. The time period under committee columns indicates committee membership and associated time period of membership, from 2011 onward. * Indicates time period as Committee Chair. *See* Molumphy Decl., Exs. 12-17.

Milligan (Since 1992)		2011-2016	2011-2016		2011-2016	Over $352,000 (¶¶ 249-252)
Peña (Since 2011)	2011-2016	2013-2016 (2016)*	2012-2016		2015-2016	Over $320,000 (¶¶ 253-257)
Quigley (Since 2013)	2011-2016 (2013-2016)*		2011-2012		2013-2016	Over $382,000 (¶¶ 258-260)
Sanger (Since 2003)			2011-2016 (2011-2016)*	2011-2016	2011-2016	Over $382,000 (¶¶ 261-264)
Swenson (Since 1998)	2011-2016		2011-2016			Over $309,000 (¶¶ 268-270)
Vautrinot (Since 2015)	2014-2016					Over $324,000 (¶¶ 271-272)

In the paragraphs referenced in the above chart, the Complaint alleges that each Director Defendant was beholden to his or her positions on the Board, to their positions on various Board committees, and to ensuring the cash and stock awards they received maintained value such that they were unable to fairly and independently asses the Board's wrongdoing related to the illegal sales tactics. *See also* Compl. Exs. L-M.

B. Roles and Responsibilities of the Officer Defendants

Each of the Officer Defendants is alleged to have been a senior executive with direct access to information relating to Well Fargo's sales practices, incentive compensation system and sales goals, employee and customer complaints, and employment termination information, and had responsibility for preventing the type of illegal sales practices that pervaded the Company:

Defendant Stumpf is the former CEO of the Company, was a member of the Board, failed to disclose the illegal sales practices, benefitted from his own breaches of fiduciary duty, and received over $19.3 million in performance-based compensation in 2015 alone. ¶ 267.

	Roles	Years in Role
John Stumpf	Chairman of the Board	Jan. 2010 - Oct. 12, 2016
	Chief Executive Officer (CEO)	June 2007 - Oct. 12, 2016
	President	Aug. 2005 - Nov. 2015

¶ 54. Stumpf has admitted "I feel accountable" (¶ 3) and apologized "for not doing more sooner to address the causes of this unacceptable activity." ¶ 117. Nevertheless, since 2011, Stumpf sold 7.1 million shares for a total of $344.6 million in profit. Compl. Ex. M.

Defendant Sloan, prior to being named CEO in October 2016, was "Stumpf's longtime lieutenant, who previously served as President, Chief Financial Officer, and Chief Operating Officer, and supervised the retail banking operations with Defendant Carrie Tolstedt, where the rampant sales fraud occurred." ¶ 18.

	Roles	Years in Role
Timothy Sloan	Board Member	Oct. 2016 - Present
	Chief Executive Officer (CEO)	Oct. 2016 - Present
	President	Nov. 2015 - Present
	Chief Operations Officer (COO)	Nov. 2015 - Oct. 2016
	Head of Wholesale Banking	2014 - 2015
	Chief Financial Officer (CFO)	2011 - 2014
	Chief Administrative Officer (CAO)	Sept. 2010 - Feb. 2011

¶ 53. Sloan, in his capacity as CFO from February 2011 to May 2014, "was required to sign periodic certifications to the company's auditors and the audit committee of the board any fraud involving management or other employees that had a significant role in the company's internal controls. The pervasive opening of sham accounts . . . would certainly seem to qualify as fraud relating to the bank's internal controls." ¶ 18. After the publication of a *Los Angeles Times* article on December 21, 2013 regarding the Company's toxic sales culture, Sloan was well aware of Wells Fargo's efforts to detect and address sales practice issues, including that a team had been assigned to investigate and that a larger sales practice review would need to be conducted, because

he was included on internal correspondence concerning the need to lower sales goals after 2013. Declaration of Mark C. Molumphy in Support of Plaintiffs' Opposition to Defendants' Demurrers ("Molumphy Decl."), Ex. 2 at 58. Nevertheless, Sloan received more than $11 million in direct compensation from the Company and sold 2.5 million shares for a total of $119.5 million in profit. ¶¶ 265-266; Compl. Ex. M.

Defendant Tolstedt was the Senior Executive Vice President (EVP), Community Banking, the division of the bank directly responsible for the illegal sales practices that pervaded the Company, from June 2007 through July 31, 2016. ¶ 58. In his Senate testimony, Stumpf was asked who "actually led community banking division, who oversaw this fraud, or the compliance division that was in charge of making sure that the bank complied with the law." ¶ 119. "Carrie Tolstedt," he replied. *Id.* Since 2011, Tolstedt sold 2.5 million shares for a total of $118.6 million in profit. Compl. Ex. M.

Defendant Shrewsberry became the CFO of both the Company and the Bank in May 2014, and was thus responsible for Wells Fargo's financial management functions including accounting and control, financial planning and analysis, line of business finance functions, asset-liability management, investor relations, and enterprise expense and efficiency. ¶ 57. Shrewsberry also serves on the Wells Fargo Operating, Management, and Market Risk Committees. *Id.* Shrewsberry sold 250,000 shares since 2011, for a total of $13.3 million in profit. Compl. Ex. M.

As alleged in the Complaint, the members of the Board approved pay raises, performance-based bonuses and lucrative golden-parachute packages based on purportedly strong revenue growth, when in fact the Company's financial performance was artificially inflated by the opening of millions of fake accounts and the execution of fraudulent banking transactions on unsuspecting customers. ¶¶ 99-104. Specifically, the Board approved base pay of $2.8 million for Defendant Stumpf, $1.7 million for Defendant Shrewsberry (later increased to $1.75 million), $2 million for Defendant Sloan, and $1.7 million to Defendant Tolstedt (later increased to $1.75 million) despite their involvement in improper sales practices, which subjected the Company to great financial and reputational harm. ¶¶ 234, 237, 243, 248, 262. In addition, the Human Resources Committee was personally involved in decisions regarding granting annual incentive awards and equity incentive

awards based largely on inflated performance metrics, which ultimately led the Board to approve total compensation packages in 2015 totaling $19.3 million for Defendant Stumpf, $9.05 million for Defendant Shrewsberry, $11 million for Defendant Sloan, and $9.05 million for Defendant Tolstedt. ¶¶ 217-18, 234.

Moreover, "Defendants STUMPF, TOLSTEDT, SHREWSBERRY and SLOAN . . . by virtue of their position and relationship with Wells Fargo, including as officers and/or directors, had access, directly or indirectly, to material information about Wells Fargo that was not generally available to the public, . . . including the Bank's illegal sales practices, as well as the warnings and complaints [regarding those practices] raised both internally by Bank employees and externally by Bank regulators." ¶ 295. The Selling Defendants "sold their Wells Fargo common stock in California at a time when they knew such material, non-public information gained from their relationship which would significantly affect the market price of that security . . ." ¶ 296.

C. "Cross-Selling" Was Integral to Wells Fargo's Business, and Pressure on Employees to Cheat to Meet Impossible Standards Was Well Known

Wells Fargo offers consumers financial products and services, including mortgages, savings accounts, checking accounts, credit cards, debit and ATM cards, and online banking services. ¶ 60. Wells Fargo sought to distinguish itself in the marketplace as a leader in "cross selling" banking products and services to its existing customers. *Id.* The Company set sales goals and implemented sales compensation incentives to increase the number of banking products and services that its employees sold to customers. *Id.* On Defendants' watch, thousands of Wells Fargo employees engaged in improper sales practices in order to satisfy sales goals and earn financial rewards under the Company's incentive compensation program. *Id.*

Wells Fargo's internal motto for cross-selling was "Eight is Great." ¶ 61. It was common knowledge throughout the Company that management wanted existing household customers to use at least eight Wells Fargo financial products and that aggressive cross selling strategies were key to driving revenue growth for the Company. ¶ 61. Wells Fargo's relentless cross selling strategy gave the appearance to the layperson and investing public that the number of products each customer utilized was increasing. ¶ 63. Wells Fargo's senior management, including Defendants, knew of, encouraged, and closely monitored compliance with the "Eight is Great" program, and

regularly received cross-selling data and discussed the push for cross-selling to securities analysts. ¶ 64.

The "Eight is Great" program was critical to the Company's bottom line and its ability to reach financial and other metrics used with its market analysts. ¶ 64. The purported legitimacy and success of the cross-selling strategy was prominently discussed in the Company's Annual Reports, annual Form 10-Ks, Quarterly Form 10-Qs, and other SEC filings. ¶ 65.

Wells Fargo's reported financial results and success with its cross selling strategy was the result of a massive fraud, including actions akin to identity theft. ¶ 68. The deceptive sales practices dated back as far back as 2002, but Wells Fargo's Board did nothing to monitor or stop such practices until regulators forced their hand in 2016. ¶ 68; *see* Compl. Exs. D at 5; *see generally* Compl. Exs. I, J, K. The Consumer Financial Protection Bureau ("CFPB") described the "enormous scale" of the scheme as not resulting from the conduct of "a few bad apples" but rather as "the consequences of a diseased orchard." ¶ 8; *see also* Compl. Ex. J at 1-2.

As part of the cross-selling strategy, Wells Fargo engaged in "simulated funding", *i.e.*, opened deposit accounts without customers' knowledge or consent and then transferred funds from authorized accounts to temporarily fund the unauthorized accounts, allowing employees to obtain credit under the incentive-compensation program. ¶ 71; *see also* Compl. Ex. C at 4-5; Ex. D; Ex. E at 3; Ex. F at 3. The illegal practices included the creation of almost two million spurious bank credit card accounts without customers' knowledge. ¶ 94; *see also* Compl. Ex. J at 1; Ex. K at 4. Wells Fargo used fake email addresses to enroll customers in online banking services without their knowledge or consent. ¶ 71, 78; *see also* Compl. Ex C at 5; Ex. J at 1. Wells Fargo made phony requests for debit cards and created personal identification numbers to activate the debit cards without the consumers' knowledge or consent and opened more than 1.5 million deposit accounts without authorization. ¶¶ 71-72, 74, 76; *see also* Compl. Ex. C at 5; Ex. J at 1; Ex. K at 4. More than 85,000 of these accounts incurred fees that would not have been incurred otherwise. ¶ 72; *see also* Compl. Ex. C at 5.

While the Complaint stands on its own, and discovery has not yet commenced numerous former Wells Fargo employees confirm the Complaint's allegations and tell astoundingly similar

1 stories about the overwhelming pressure to meet sales goals and the illicit practices they either
2 observed at their branches or were forced to engage in themselves. *See, e.g.*, Molumphy Decl., Ex.
3 4 (former banker in California routinely observed his branch management instruct employees to
4 "round up" undocumented day laborers waiting for work at the local 7-Eleven and to bring them
5 back to sign them up for accounts in exchange for "waiving" check-cashing fees); Ex. 5 (former
6 teller and branch manager in Pennsylvania reports that upper management at her Wells Fargo
7 "store" instituted a program called "Hit the Streets Thursday," where management directed tellers
8 of Latino/a descent to patrol the streets and local social security offices to "force" random people
9 of the streets and into branches to open unauthorized accounts); Ex. 6 (former banker and store
10 manager in Arizona reported illegal sales practices to Wells Fargo's EthicsLine twice, was
11 subsequently told not to report the practices to the EthicsLine, and after repeatedly expressing
12 concern to management about the fraudulent activity, was told to "play ball or get out."); Ex. 7
13 (former employee in Wisconsin recounts that her branch employees would travel to college
14 campuses with pre-filled forms to sign students up for accounts and use signature cards from the
15 students to later open additional unwanted accounts); Ex. 8 (former employee in Utah recounts that
16 her management required tellers and bankers to keep daily written logs of customer interactions
17 and efforts used to convince customers to sign up for unnecessary accounts and also targeted
18 undocumented workers at nearby construction sites and a factory to create additional accounts);
19 Ex. 9 (former New Jersey banker reports that management instructed employees to check customer
20 accounts to see if they had children and to sign up any children for credit cards and that he reported
21 to upper management the fake accounts, pressure, and unethical practices he observed); Ex. 10
22 (former wellness call center employee recounts that over 90% of callers were Wells Fargo
23 employees who reported experiencing extreme stress, anxiety, and depression because of the sales
24 pressure and practices); Ex. 11 (Wells Fargo customer recalls numerous times she was issued
25 unwanted products and emailed her complaints to Defendant Stumpf and the Board).

26 **D. Regulator Investigations and Customer and Employee Complaints Alerted**
27 **Defendants to the Wrongful Conduct**

The illegal sales practices date back to 2002 and continued into 2016, and during this
28 period, Wells Fargo's own regulators alerted the Board and senior management to sales abuse and

risk management issues that went unaddressed for years. *See, e.g.,* ¶ 92; Compl. Ex. C at 5; *see generally* Compl. Exs. I, J.

Governmental investigations revealed the grand scale of Wells Fargo's misconduct and that Defendants had been alerted to this misconduct but failed to act before the investigations came to the public forum. On September 20, 2016, the U.S. Senate Committee on Senate Banking, Housing & Urban Affairs ("Senate Banking Committee") held a hearing on Wells Fargo's sales practices. ¶ 104; *see also* Compl. Exs. I, J, K. Written remarks prepared for the Senate Banking Committee confirmed that Defendants knew about the improper behavior for years. ¶¶ 105-115; *see also* Compl. Exs. I, J, K. Defendant Stumpf's testimony to the Senate Banking Committee also acknowledges that Wells Fargo had specific knowledge of sales practice violations as early as 2011. ¶ 117; Compl. Ex. K at 2.

The Senate Banking Committee expressed clear frustration with the Board's lack of accountability and "made clear that they think the [B]oard, which has known about the [B]ank's 'cross-selling' problems since 2013, should have acted more quickly to clean up the mess – especially on deciding whether to claw back compensation from top executives . . ." ¶ 125.

However, the regulatory red flags were waving much earlier. For example, following an examination which took place in 2011, the Office of the Comptroller of the Currency ("OCC") escalated its actions in order to spur Wells Fargo and its Board to address complaints relating to the sales practices. In early 2012, the OCC received additional complaints from consumers and Bank employees alleging improper sales practices at Wells Fargo. ¶ 107; Compl. Ex. I at 3. The OCC issued Supervisory Letters in February of 2013 requiring the Company to implement a compliance program. ¶ 107; *see also* Compl. Ex. I at 4-5. In December 2013, the OCC examiners again initiated a series of meetings with various levels of Wells Fargo management, including executive leadership, to evaluate the Bank's activities and lack of actions relating to improper sales practices. Compl. Ex. I at 4-5.

In 2014, the OCC also instructed the Bank to establish a comprehensive compliance risk management program related to unfair and deceptive practices, and specifically identified the need to assess cross-selling and sales practices as part of its upcoming examination of the Bank's

governance process. Compl. Ex. I at 4-5. The OCC continued to meet with Bank Management throughout 2014. *Id.*

In early 2014, the OCC directed the Bank to "address weaknesses in compliance risk" by establishing a comprehensive plan to prevent "unfair and deceptive practices" and determined that the cross selling sales practices should be scrutinized in an examination of the Bank's governance processes. ¶ 107; Compl. Ex. I at 5. The OCC continued its close scrutiny of the Bank's sales practices in 2015, which "included meetings with Bank management and review of extensive documentation, including internal reports, board packages, and internal audit findings." ¶ 108; Compl. Ex. I at 5-8.

Despite all these prior warnings from the OCC, the practices continued. Ultimately, the OCC concluded that "the Bank lacked a formalized governance framework to oversee sales practices," causing the OCC to send a Supervisory Letter to Wells Fargo in April 2015 that identified specific "Matters Requiring Attention" in the Community Banking division. ¶ 110; Compl. Ex. I at 6. The OCC's scrutiny of the Bank's activities continued into 2016 with the OCC holding monthly meetings with Bank Management to monitor the Bank's progress. ¶ 114; Compl. Ex. I at 8. The OCC concluded its 2016 examination work in July 2016 and issued its Report of Examination findings and a letter to the Board. ¶ 114; Compl. Ex. I at 6.

The OCC's Report of Examination concluded that "the Bank's sales practices were unethical; the Bank's actions caused harm to consumers; and Bank management had not responded promptly to address these issues." ¶ 114 *see* Compl. Ex. I at 7. In July 2015, the OCC issued a Notice of Deficiency, citing the Bank's failure to comply with prior admonitions. ¶ 113; Compl. Ex. I at 7-8. On September 8, 2016 the OCC announced the results of its investigation into Wells Fargo's sales practices, and entry of two Consent Orders against the Bank: (1) a "cease and desist" order and (2) an order requiring the Bank to pay a civil monetary penalty of $35 million. ¶ 85; *see generally* Compl. Exs. B, D-H, I, J. The OCC found that the Bank's illegal conduct was not isolated in scope and "the Bank engaged in reckless unsafe or unsound banking practices that were part of a pattern of misconduct." ¶ 89; *see* Compl. Exs. D-H; Ex. I at 8.

Also in September 2016, the CFPB entered Consent Orders against Wells Fargo Bank. ¶ 4;

1 *see generally* Compl. Ex. C. The Consent Orders require Wells Fargo to revamp its corporate
2 governance structure and provide accountability of management. ¶ 12; *see generally* Compl. Exs.
3 E-H, I, J. The Consent Orders require Wells Fargo to issue full refunds to affected consumers and
4 ensure the Bank engages in proper sales practices going forward. ¶ 12; *see* Compl. Exs. D-H.
5 Wells Fargo must pay a $100 million fine to the CFPB, and the Bank has agreed to pay an
6 additional $85 million in fines to the OCC and other entities. ¶ 13; *see* Compl. Ex. B at 17; Exs.
7 C-J. The CFPB concluded that Wells Fargo's conduct was in violation of Consumer Financial
8 Protection Act sections 1031(c)(1), (d)(1), (d)(2)(B), and 1036(a)(1)(B). ¶¶ 73, 75, 77, 79; Compl.
9 Ex. B at 4-10.

10 Defendants were not only alerted to the massive fraud occurring through their cross-selling
11 program by outside regulators, but also received numerous internal indicators of problems. Under
12 Defendants' watch, Wells Fargo fostered a pervasive, Company-wide culture in which employees
13 were pressured to engage in misconduct simply to keep their jobs, and the illegal practices
14 permeated the Company's operations. ¶ 95. Dating back to at least 2011, Wells Fargo reportedly
15 fired over 5,300 employees based on the illegal sales practices, and about 10% of the terminated
16 employees were branch managers or senior to such managers. ¶ 93; *see also* Ex. J at 1-2; Ex. K at
17 3.

18 Despite the ongoing illicit conduct, Defendants allowed several high-ranking employees,
19 including those with responsibility for the illegal sales practices, to "resign" from the Company
20 instead of acting to clawback compensation paid to such employees. ¶ 99. Defendants also
21 approved pay raises, performance based bonuses, and lucrative golden parachute packages to such
22 individuals. *Id.* For example, in July 2016, Defendant Tolstedt announced she would be retiring,
23 reportedly taking $124.6 million in stock, options, and restricted shares. ¶ 58. None of the
24 Defendants informed the shareholders or the public that Tolstedt would be paid this "golden
25 parachute" despite her active involvement in Wells Fargo's misconduct. ¶ 101. Wells Fargo also
26 allowed Defendant Stumpf, the former Chief Executive Officer and Chairman of the Board of
27 Directors, to resign and retain the vast majority of his compensation package previously approved
28 by the Board while the cross-selling scheme was occurring. ¶ 17. The Board then replaced

Defendant Stumpf with Defendant Sloan, who previously served as President, CFO, and COO, and supervised the retail banking operations with Defendant Tolstedt. ¶ 18.

The Directors Defendants were also generously compensated despite the fact that they were kept informed about the cross-selling scheme and promoting its "success" without implementing controls to oversee the cross-selling program, without adequately monitoring the program, and without disclosing the risks and true actions behind the cross-selling practices. ¶¶ 64-67, 98, 228-272. The Director Defendants additionally knew of or recklessly permitted the illegal sales practices described in the Consent Orders, approved the compensation structures which incentivized employees to engage in the illegal sales practices, approved lucrative compensation packages to senior management and refused to take action or claw back such compensation, concealed the conduct from regulators and investors, and failed to implement any meaningful changes to end the illegal sales practices and/or eliminate the employee incentives which encouraged such practices, even after specific warnings had been brought to their attention. ¶ 228.

E. Numerous, Obvious Red Flags Were Available to the Board

Beginning at least in 2002, and continuing for over a decade until 2014 and 2015, the Officer and Director Defendants were aware of numerous red flags of improper sales practices from employees, customers, and bank regulators:

2002: Audit and Examination Committee begins receiving quarterly Audit & Security Reports, which discuss sales integrity issues; Reports issued in "most quarters" between 2002 and 2016.

> "Going back to at least 2002, [Audit & Examination] committee materials referenced ***sales conduct or 'gaming' issues***. They arose in two sections of the quarterly A&E Committee package . . . Some reports from the BSA Officer specifically referred to "***sales integrity" SARs***; others did not. Second, Wells Fargo Audit & Security (renamed Wells Fargo Audit Services in 2012, both "WFAS") also prepared a quarterly report of 50-150 pages covering multiple topics . . . The WFAS report referred to ***sales integrity*** . . . ***EthicsLine reports and resulting investigations from anonymous reports of 'possible violations of the Code of Ethics, violations of law, and suspicious activity' involving employees could [] include sales practices***. The WFAS reports ***referenced allegations and investigations concerning sales practices in most, but not all, quarters***." Molumphy Decl., Ex. 2 at 98-99.

2005: The Board's Audit Committee identifies sales issues in its reports, and the full Board begins receiving the quarterly Audit & Security Reports discussing sales integrity issues and practices, employee terminations.

"The ***issues with sales practices*** were identified in the bank's audit committee reports as early as 2005." "Since 2005, the bank's Board received regular Audit & Security reports indicating the highest level of ***EthicsLine internal complaint cases, employee terminations***." Molumphy Decl., Ex. 3 at 4 and 5.

1/13/2010: Meeting between OCC and senior Bank management to discuss the high number of whistleblower complaints (700) related to gaming of incentive plans. *Id.*, at 5.

3/22/2010: OCC Supervisory Letter 2009-46 – The OCC issues a Matters Requiring Attention notice requiring Wells Fargo to immediately implement an enterprise-wide system for complaint management.

"This MRA remained uncorrected and was incorporated into the 2016 consent order." Molumphy Decl., Ex.3 at 4.[6]

2010: OCC Supervisory Letter 2010-38 – Fraud Risk Management, "focused on evaluating the adequacy of the overall whistleblower processes." *Id.*, at 5.

9/30/2010: OCC Core Assessment issued, "attributing the [internal whistleblower] complaints to cross-selling incentives." *Id.*, at 5.

2011: The Risk Committee of the Board created to oversee risk across the enterprise.

"This involved a multi-year plan starting in 2013 to substantially grow Corporate Risk, to move toward centralization of more risk functions and to enhance Corporate Risk's ability to oversee the management of risk in the lines of business. Consistent with this plan, the Board supported major funding increases for Corporate Risk for 2014-2016. But, as problems with sales practices in the Community Bank became more apparent in 2013-2015, Corporate Risk was still a work in progress and the Chief Risk Officer had limited authority with respect to the Community Bank." Molumphy Decl., Ex. 2 at 12.

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[6] According to the OCC, "Matters Requiring Attention" or "MRAs" are particularly important notices to a bank and "***describe practices that deviate from sound governance, internal control, and risk management principles***, and have the potential to adversely affect the bank's condition, including its financial performance or risk profile, if not addressed; or result in substantive noncompliance with laws and regulations, enforcement actions, supervisory guidance, or conditions imposed in writing in connection with the approval of any application by the bank. . . ***MRAs focus the bank's management and board's attention on supervisory concerns that require the board's immediate acknowledgement and oversight to ensure timely corrective action***." Compl. Ex. I at 3.

A Supervisory Letter is "an official OCC communication that formally conveys supervisory findings and conclusions, including any supervisory concerns, from the OCC's ongoing supervision of the institution." Compl. Ex. I at 5.

2/2013: The OCC issues a Supervisory Letter to Wells Fargo, "requiring the Bank to develop its operational risk compliance program." Compl. Ex. I at 5.

7/18/2013: Wells Fargo commissions report from McKinsey & Co., which concludes that "the bank needs a centralized consumer complaint analysis process." Molumphy Decl., Ex. 3 at 6.

12/22/2013: *Los Angeles Times* Article, "Wells Fargo's Pressure-Cooker Sales Culture Comes at a Cost." (Molumphy Decl., Ex. 21) quoted Bank documents, court records and current and former employees

Early 2014: The OCC conducts a series of meetings with various levels of Bank management, including executive leadership, regarding its sales practices, and directs the bank to address weaknesses including cross-selling and sales practices. Compl. Ex. I at 4.

The OCC "directed the Bank to address weaknesses in compliance risk through the establishment of a comprehensive compliance risk management program related to unfair and deceptive practices. [T]he OCC identified ***the need to assess cross-selling and sales practices*** as part of its upcoming examination of the Bank's governance processes." *Id.* at 5.

2/2014: Sales practices identified as a "high risk" activity to the Board and the Risk Committee.

"The directors in 2014 received reports from the Community Bank, from Corporate Risk and from Corporate Human Resources that sales practice issues were receiving scrutiny and attention . . ." Molumphy Decl., Ex. 2 at 15.

2/2015: The OCC conducts an examination of Wells Fargo's Community Bank Operational Risk Management, including "evaluat[ion] of the Community Bank division's sales practices oversight." Compl. Ex. I at 6.

4/2015: The OCC issues a Supervisory Letter that included a Matters Requiring Attention notice "requiring the Bank to address the governance of sales practices within its Community Bank division." Compl. Ex. I at 6.

5/2015: The Los Angeles city attorney filed a lawsuit alleging widespread improper sales practices at Wells Fargo branches in Los Angeles. Molumphy Decl., Ex. 22.

"From May 2015 . . . the Board's and Risk Committee's meetings addressed sales practice issues, resolving the Los Angeles litigation, responding to regulatory concerns and remediating customer harm." Molumphy Decl., Ex. 2 at 15.

6/2015: The OCC issued an additional Supervisory Letter to the Chairman and CEO of Wells Fargo, "identifying matters related to the Bank's enterprise-wide risk management and oversight of its sales practices that required corrective action by the Bank," which "included five MRAs that required the Bank to take significant action to address the inappropriate tone at the top, that included the lack of an appropriate control or oversight structure given corporate emphasis on product sales and cross-selling, [etc.] . . . The OCC [] instructed the Bank to remediate any

consumer harm that resulted from the sales practices at issue." Compl. Ex. I at 6-7.

7/2015: The OCC annual Report of Examination issued, noting Wells Fargo "needed to act more proactively to control compliance and operational risk." Compl. Ex. I at 7.

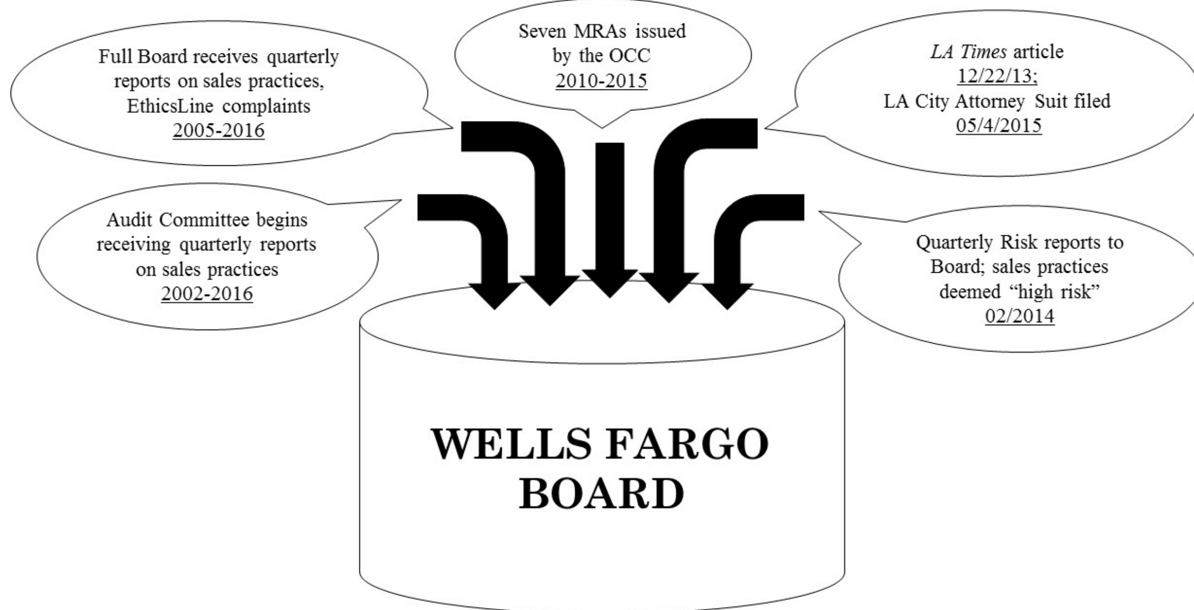
7/28/2015: The OCC issues a Notice of Deficiency, citing "the Bank's failure to comply with the [OCC's] safety and soundness expectations." Compl. Ex. I at 7-8.

7/18/2016: An OCC Report of Examination concluded that "the Bank's sales practices were unethical; the Bank's actions caused harm to consumers; and Bank management had not responded promptly to address these issues."

A Supervisory Letter to the Board stated "the Bank engaged in unsafe or unsound banking practices and shortly thereafter, the OCC's Major Matters Supervision Review Committee approved recommendations to issue the Consent Order and assess CPMs against the Bank for reckless or unsound sales practices and the Bank's risk management and oversight of those practices." Compl. Ex. I at 8.

9/8/2016: OCC, CFPB, and L.A. City Attorney enforcement actions issued – Penalties total $185 million. *See, e.g.*, ¶ 13; Compl. Exs. C-H.

The Board heard but did not act on these red flags:



See also Molumphy Decl., Ex. 1.

F. The Truth Continues to Unfold: Additional Revelations of Sales Abuses After the Complaint Was Filed, Additional Damages to Company

In the few months since the Complaint was filed, additional evidence has been uncovered confirming the allegations therein and adding to the damages the Bank and its shareholders have

suffered from the sale abuse scheme. A representative example includes:

- On February 1, 2017, Wells Fargo filed its 2016 Annual Report and, in a section entitled, "Sales Practices Matters," disclosed that "Federal, state, and local governmental agencies, including the United States Department of Justice, the United States Securities and Exchange Commission and the United States Department of Labor, and state attorneys general and prosecutors' offices, as well as Congressional committees, have undertaken formal or informal inquiries, investigations or examinations arising out of certain sales practices" that were the subject of the regulatory settlements. *See* Molumphy Decl., Ex. 18 at 214.
- On March 15, 2017, Well Fargo filed its 2017 Proxy stating the U.S. Department of Justice is investigating Wells Fargo's sales practices. Molumphy Decl., Ex. 17 at 85. The Proxy also discloses that the U.S. Department of Labor is engaging in a "top-to-bottom review" of Wells Fargo for potential federal labor law violations. *Id.* Wells Fargo reported that, in conjunction with a third party expert, it is conducting an internal review of its ethics hotline. Molumphy Decl., Ex. 17 at 87. Wells Fargo intends to use the same third party to institute a review of potential concerns raised by employees who felt retaliating against for reporting conduct to the internal ethics hotline. *Id.*
- On March 28, 2017, Wells Fargo announced a $110 million class action settlement covering Bank customers damaged from the illegal sales practices back to ***2009***. Yet, just weeks later, Wells Fargo announced it was adding $32 million to settlement, or $142 million total, ***based on discovery sales abuses dated back to 2002***. *Id.*, Ex. 19.
- On April 3, 2017, the U.S. Department of Labor's Occupational Safety and Health Administration (OSHA) ordered Wells Fargo to issue monetary compensation and immediately reinstate a former Bank manager who reported fraudulent conduct to bank management and Wells Fargo's ethics hotline. Molumphy Decl., Ex. 20. OSHA ordered Wells Fargo to pay the former Los Angeles manager back pay, compensatory damages, and attorneys' fees, which were collectively estimated to be a total of $5.4 million. *Id.*

- On April 10, 2017, the Board issued its Report on sales practices. Molumphy Decl., Ex. 2.
- On April 19, 2017, the OCC issued its "Lessons Learned." *Id.*, Ex. 3.
- On April 25, 2017, Wells Fargo held its annual shareholder meeting. Molumphy Decl., Ex. 23. Several directors, including members of the Board's Risk and Corporate Responsibility Committees, barely received over 50% of votes despite running unopposed and with the Company's recommendation. Defendant Sanger (Chair of Board) received 56% of votes; Defendant Hernandez (Chair of the Risk Committee) received 53%; Defendant Pena (Chair of Corporate Responsibility Committee) received 54%; Defendant Quigley (Chair of Audit Committee) received 65%, and Defendant Lloyd Dean (Chair of Human Resources Committee) received 62%. *Id.* In Wells Fargo's Press Release that followed, Defendant Sanger stated, "Wells Fargo stockholders today have sent the entire Board a clear message of dissatisfaction . . . "[T]hey also feel the understandable need to hold the entire Board accountable for not moving quickly enough before that to address these issues – and that is the reason why all except our newest directors received support from 80 percent or less of shares voted today." Molumphy Decl., Ex. 24.

III. <u>ARGUMENT</u>

A. Plaintiffs Adequately Alleged Demand Futility

1. <u>Legal Standard for Demand Futility</u>

A derivative suit is a potent tool "to redress the conduct of a torpid or unfaithful management." *Aronson v. Lewis* (Del. 1984) 473 A.2d 805, 811. Accordingly, California law permits derivative suits without requiring a demand where demand is futile. Cal. Corp. Code § 800(b)(2) (derivative suits allowed if "[t]he plaintiff alleges in the complaint with particularity. . . the reasons for not making" a demand). Demand futility is analyzed under the law of the state of incorporation, here, Delaware. *Charter Twp. Of Clinton Police & Fire Ret. Sys. v. Martin* (2013) 219 Cal.App.4th 924, 934.

A shareholder plaintiff does not need to plead evidentiary facts, nor prove a likelihood of success on the merits, in order to allege demand futility. *See Levine v. Smith* (Del. 1991) 591 A.2d 194, 207; *Rales v. Blasband* (Del. 1993) 634 A.2d 927, 934. Rather, in determining demand futility, courts must accept all particularized allegations as true and draw all reasonable inferences in plaintiffs' favor that logically flow from such allegations. *Rales*, *supra*, 634 A.2d at 931; *see also Brehm v. Eisner* (Del. 2000) 746 A.2d 244, 255; *Del. Cty. Emples. Ret. Fund v. Sanchez* (Del. 2015) 124 A.3d 1017, 1019. Further, where a complaint advances several reasons supporting demand futility, a court must consider the totality of these circumstances to assess whether a reasonable doubt is raised regarding directors' disinterest or independence. *Id.*; *see also Bergstein v. Texas Int'l Co.* (Del. Ch. 1928) 453 A.2d 467, 469.

Delaware law employs different tests to determine whether demand is excused. *In re Oxford Health Plans, Inc. Sec. Litig.* (S.D.N.Y. 2000) 192 F.R.D. 111, 116 ("[T]he issue is fact intensive and no two cases are alike."). Where a conscious board decision is challenged, *Aronson* applies. *Id.*; *see also Aronson, supra,* 473 A.2d 805, *rev'd on other grounds by Brehm*, 746 A.2d at 244. Plaintiffs may demonstrate that a demand would be futile by alleging facts that create a "reasonable doubt" that either (1) a majority of the board was disinterested or independent in the transaction; ***or*** (2) the transaction was a product of the board's valid exercise of business judgment. *Aronson*, 473 A.2d at 814-15. Where the lawsuit challenges something other than a conscious board decision, the *Rales* test applies. *Rales*, 634 A.2d at 934. Demand is excused under *Rales* if, drawing all inferences in Plaintiffs' favor, the facts alleged "create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand." *Rales*, 634 A.2d at 934.

A derivative complaint need only raise a "reasonable doubt" as to the disinterestedness or independence of a majority of the board of directors. *Rales*, 634 A.2d at 933 (citing *Aronson*, 473 A.2d at 814). Under both *Rales* and *Aronson*, a shareholder plaintiff raises a reasonable doubt by alleging facts that, if presumed to be true, would subject a majority of the Board's directors to a substantial likelihood of liability. *In re INFOUSA, Inc. S'holders Litig.*, 953 A.2d 963, 889-90 (Del. Ch. 2007). "[T]o show … a 'substantial risk of liability,' the plaintiff does not have to

demonstrate a reasonable probability of success on the claim." *Louisiana Mun. Police Employees' Ret. Sys. v. Pyott* (Del. Ch. 2012) 46 A.3d 313, 351, *rev'd on other grounds sub nom. Pyott v. Louisiana Mun. Police Employees' Ret. Sys.* (Del. 2013) 74 A.3d 612. Rather, "Plaintiffs need only 'make a threshold showing, through the allegation of particularized facts, that their claims have some merit.'" *Id.* (citing *Rales*, 634, A.2d at 934).

"[T]he concept of reasonable doubt is akin to the concept that the stockholder has a 'reasonable belief that the board lacks independence or that the transaction was not protected by the business judgment rule. The concept of reasonable belief is an objective test….'" *In re Ezcorp Inc. Consulting Agree. Derivative Litig.* (Del. Ch. Jan. 25, 2016) No. 9962-VCL, 2016 WL 301245, at *33 (internal citation omitted). "The totality of the complaint's allegations need only support a reasonable doubt of business judgment protection, not a judicial finding that the directors' actions are not protected by the business judgment rule." *In re Abbott Labor. Derivative S'holders Litig*. (7th Cir. 2003) 325 F.3d 795, 809 (applying Delaware law) (internal citations omitted).

In sum, the "demand futility" question before this Court is whether the Complaint alleges sufficient facts which, presumed to be true and with all reasonable inferences drawn in Plaintiffs' favor, create at least a reason to doubt that a majority of Wells Fargo's Board – 8 of 15 members – could consider a demand to sue themselves with independence and disinterest. The Complaint satisfies this standard.

2. Defendants' Characterization of Plaintiffs' Claims Is Irrelevant

Wells Fargo cites *In re Caremark Int'l Inc. Derivative Litig.* (Del Ch. 1996) 698 A.2d 967, for the proposition that, to establish liability for a director's failure of oversight, a shareholder must allege facts demonstrating either: "(a) the directors *utterly failed* to implement any reporting or information system or controls; ***or*** (b) having implemented such a system or controls, *consciously failed* to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention. . ." *See* WF Br. at 8:23-27. As Wells Fargo notes, these are alternative theories of liability. Here, Plaintiffs alleged both types of *Caremark* claims.

In its demurrer, Wells Fargo confusingly tries to compartmentalize the claims into one of

the two types of claims. WF Br. at 8-9, and fn. 7. However, it does not matter how they are characterized or even if they are characterized as *Caremark* claims at all. Plaintiffs' allegations that the Board made a conscious decision to "turn a blind eye" to wrongdoing and illegality can be assessed "either as a *Caremark*-type oversight claim or as an *Aronson* type allegation of considered board action." *Rosenbloom v. Pyott* ("*Rosenbloom*") (9th Cir. 2014) 765 F.3d 1137, 1150-51 (court "need not decide which characterization of Plaintiffs' allegations is correct because, either way, demand is excused if Plaintiffs' particularized allegations create a reasonable doubt as to whether a majority of the board faces a substantial likelihood of liability for failing to act in the face of a known duty to act.").

Thus, under either *Caremark* or *Aronson*, Plaintiffs have adequately alleged that the Board faces a substantial likelihood of liability and demand is futile.

3. Demand is Futile Because A Majority of Board Members Face a Substantial Likelihood of Liability

"[O]ne cannot act loyally as a corporate director by causing the corporation to violate the positive laws it is obliged to obey." *Guttman v. Jen-Hsun Huang* (Del. Ch. 2003) 823 A.2d 492,506 n.34; *see also In re Am. Int'l Grp., Inc., Consol. Derivative Litig.* ("*AIG*") (Del. Ch. 2009) 976 A.2d 872, 889, *aff'd sub nom. Teachers' Ret. Sys. of Louisiana v. Gen. Re Corp.* (Del. 2010) 11 A.3d 228 ("[I]t is generally accepted that a derivative suit may be asserted by an innocent stockholder on behalf of a corporation against corporate fiduciaries who knowingly caused the corporation to commit illegal acts and, as a result, caused the corporation to suffer harm."). Indeed, "[w]here 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***." *Stone ex rel. AmSouth Bancorporation v. Ritter* ("*Stone*") (Del. 2006) 911 A.2d 362, 370 (emphasis added, citing *In re Walt Disney Co. Deriv. Litig.* (Del. 2006) 906 A.2d 27, 67, and *Guttman*, *supra*, 823 A.2d at 506).

Here, the Director Defendants' illegal conduct subjects them to liability for breach of fiduciary duty, unjust enrichment, corporate waste and insider-selling. Among other actions, their wrongful conduct includes engaging "in reckless or unsound banking practices that were part of a

1 pattern of misconduct" (¶¶ 87, 89); utterly failing to provide oversight to prevent and correct these
2 practices (¶ 87); lacking a complaint monitoring process to assess risk (*Id.*); failing to adequately
3 oversee sales practices and monitor employees (*Id.*); inadequately auditing the sales practices (*Id.*);
4 pressuring employees engage in misconduct (¶ 95), encouraging and endorsing a company culture
5 that increased this pressure (*Id.*); approving pay raises, performance-based compensation, and
6 lucrative golden parachute packages tied to the illegal sales practices (¶¶ 99, 103); concealing
7 fraudulent enrollment of My Term insurance policies (*see* ¶¶ 129-157); breaching their duties of
8 care, good faith, and loyalty (¶¶ 222-225, 273-276); unjustly retaining compensation tied to their
9 misconduct and wasting corporate assets regarding the same compensation and conduct (¶¶ 103,
10 277-285); failing to disclose the fraud that underlined the "success" represented in the public
11 filings they approved (¶¶ 64-67); and, for Stumpf, Sloan, Shrewsberry, and Tolstedt, trading on
12 this material, non-public information (¶¶ 265, 295-299).
13 In addition, the facts support an inference that the Director Defendants "fail[ed] to act"
14 despite knowledge of any of the alleged conduct, rendering subject to liability. *Stone, supra*, 911
15 A.2d at 370; *see also Rosenbloom, supra,* 765 F.3d at 1153 (excusing demand where facts
16 supported "an inference of Board knowledge and intentional disregard" of violations of law).
17 In *Rosenbloom*, the Ninth Circuit, applying Delaware law, held that demand was excused
18 as to Allergan's entire board because the facts permitted the reasonable inference that the board
19 had "actual or constructive knowledge of violations of the law at Allergan . . . and did nothing."
20 765 F.3d at 1151. The plaintiffs alleged that the board monitored off-label Botox sales,
21 emphasized Botox's importance to Allergan's success, repeatedly received information during
22 board meetings concerning off-label sales, had data linking Allergan's off-label promotions with
23 Botox sales figures, and received repeated FDA warnings about off-label promotions. *Id.* at 1151–
24 53. Combined with the importance of Botox to Allergan, and the magnitude and duration of the
25 wrongdoing, these facts led the Ninth Circuit to find "an inference of Board knowledge and
26 intentional disregard" of Allergan's illegal conduct. *Rosenbloom,* 765 F.3d at 1153.
27 Here, the inference of knowledge is even stronger than it was in *Rosenbloom*, since the
28 Director Defendants (1) explicitly endorsed and encouraged a company culture that pressured

employees to engage in illicit sales practices (¶ 95); (2), regularly received updates and discussed pushing the sales practices to securities analysts (¶ 64); (3) consistently touted the "legitimacy" and "success" of the practices, including in the Bank's financial statements (¶¶ 65-67); (4) received, yet failed to act on reports identifying sales practices as "High" risk (Molumphy Decl. Ex. 2; and (5) nevertheless approved each financial report omitting the misconduct and risk behind the sales practices (*see id.*). *See also* Molumphy Decl., Exs. 1-3. While this Court could excuse demand on this basis alone, the Complaint alleges even more.

In addition to the Defendants' conscious disregard of their duties and failure to disclose the truth of the cross-selling activities, the Complaint alleges facts permitting the reasonable inference that Defendants had knowledge of the Company's ethical and regulatory violations. The following allegations all support the reasonable inference that Defendants knew of the Company's misconduct: (1) selling consumer and financial services is Wells Fargo's entire business (*see, e.g.*, ¶¶ 60, 64); (2) the Company, with Defendants' knowledge and encouragement, instituted the "Eight is Great"[7] cross-selling program (*see, e.g.*, ¶¶ 61-64); (3) Wells Fargo and Individual Defendants aggressively pushed the cross-selling program and incentivized illicit sales practices to meet the lofty goals set for employees (¶¶ 4, 8-10, 12, 17-18, 61-64; *see also former E'ee Decls* (4) the Board ignored years of warnings regarding the misconduct and risk despite receiving regular updates and analysis of the misaligned cross-sale statistics (*see, e.g.*, ¶¶ 8, 9, 20, 22, 64, 72, 87-89, 92-97); and (5) simultaneously touted the feigned success of the sales practices without disclosing the illegality thereof (¶¶ 65-67). *See generally Rosenbloom* at 1151–53; *see also id.* at 1152 ("[T]he Board emphasized that Botox is 'critical to the success of our [strategic] plan' and discussed key assumptions' related to the acquisition of [a company allegedly intended to help with off-label sales]. We can—and at this stage, must—reasonably infer that the Board's discussion of these matters afforded its members a view of Allergan's illegal conduct.").

Moreover, as in *Rosenbloom*, the Board was aware that its primary governmental regulator, the OCC, was not only investigating its sales practices but imposing MRAs and ordering Wells Fargo to modify its oversight practices to assess the risk of cross-selling, as early as 2010. ¶¶ 107-

[7] This program is also commonly referred to as "Gr-Eight."

108; *see also* Molumphy Decl., Exs. 1-3. The reasonable inference that the Board knew of, consciously disregarded, failed to prevent, and failed to correct repeated and unlawful sales practices at the Bank is akin to, if not stronger than, the allegations asserted in *Rosenbloom*. *Id.*

In addition, a Board's notice of prominent "red flags" at a company creates the reasonable inference at the pleading stage that they were also elevated with the company, and that directors had constructive knowledge of the violations. *In re Abbott Labs. Deriv. S'holders Litig.* (7th Cir. 2003) 325 F.3d 795, 809 (applying Delaware law, the court found that "[g]iven the extensive paper trail in Abbott concerning the violations and the inferred awareness of the problems, the facts support a reasonable assumption that there was a sustained and systematic failure of the board to exercise oversight"); *see also ATR-Kim Eng Financial Corp. v. Araneta* (Del Ch. Dec. 21, 2006) 2006 WL 3783520 at *21 (holding that the board "consciously abandoned any attempt to perform their duties independently and impartially" because it "never bothered to check" the company's assets).

Wells Fargo superficially relies on two cases to support its claim that the Complaint lacks sufficient allegations of Board knowledge. WF Br. at 10:20-26 (citing *KBC Asset Mgmt. NV v. McNamara* (D. Del. May 12, 2016) 2016 WL 2758256, at *1 and *Reiter v. Fairbank* (Del. Ch. Oct. 18, 2016) 2016 WL 6081823, at *13-15. However, neither case is applicable. In *Reiter*, the court found that the plaintiff did not plead true red flags, *i.e.*, that the regulatory investigations did not result in findings of violations so they did not constitute red flags. *Reiter*, *supra*, 2016 WL 6081823, at *13-15. Similarly, in *KBC*, the court, without a detailed analysis, concluded that plaintiffs alleged negative facts but provided no basis to inferring that the Board did or should have been aware of those facts. *KBC*, *supra*, 2016 WL 2758256, at *3.

Obviously, that is not even close to the case here; the investigations not only resulted in OCC's findings of violations, Wells Fargo paid substantial fines based on the Consent Orders and the Director Defendants then signed Stipulations consenting to the Consent Orders. Moreover, the Complaint does allege Defendants had knowledge of the underlying sales practices, as well as a variety of red flags that together support an inference that the Defendants knew or should have known of material weaknesses in the oversight function and internal controls, and they failed to

correct such weaknesses and misconduct.

First, Defendants, were or should have been aware that cross-selling practices were too lofty to be met and were pressuring employees to engage in illicit sales that did not track with the Company's volume or historic sales statistics. Wells Fargo continued to "sell" and the Defendants continued to encourage the "selling" of millions of accounts despite pervasive warnings of the misconduct. *See, e.g.*, ¶¶ 8, 9, 20, 22, 61-64, 72, 87-89, 92-97; *see also* Molumphy Decl., Exs. 4-11. Defendant Stumpf's testimony also confirms that the Defendants knew of the misconduct. *See* ¶ 117. At the same time, the U.S. government was also already investigating and issuing reports regarding the sales abuses and risks. *See* ¶¶ 107-114; Exhibit I; *see also* Molumphy Decl., Exs. 1-3.

Second, Defendants were aware of the importance of due diligence, internal controls, and oversight regarding its overall business and governance. *See, e.g.*, ¶¶ 192-201 (discussion of the Company's Code of Ethics and Business Conduct and Vision and Values); ¶¶ 202-206 (the Company's Corporate Governance); ¶¶ 207-220 (Board Committee Charters including committees for governance, corporate responsibility, risk, and human resources).

Moreover, Courts have found demand futility sufficiently pled where, as here, the failure in oversight was related to a "fundamental part of [the Company]'s business." *In Re Countrywide Financial Corp.*, (C.D. Cal. 2008) 554 F. Supp. 2d 1044 (failure of oversight was related to an integral part of a business: "quality of the loans originated and adherence to underwriting standards"). In *Countrywide*, the plaintiffs alleged that the board and board committees were responsible for monitoring the performance of the company's loan portfolio and demand futility was alleged where a "widespread Company culture that encouraged employees to push mortgages through without regard to underwriting standards." 554 F.Supp.2d at 1081-82.

Like in *Countrywide*, Defendants here sought to maximize revenue by increasing Wells Fargo's "sales" from cross-selling practices and by incentivizing impossible-to-meet sales targets. ¶¶ 4, 8-10, 12, 17-18, 61-67. These practices were open, notorious and widespread. *See, e.g.*, ¶¶ 8-9; *see also* Molumphy Decl., Exs. 2, 4-11. Yet, Defendants systematically failed to oversee the sales practices they endorsed, praised, and profited from despite the fact that these sales constituted

a "fundamental part of [Wells Fargo]'s business." *See Countrywide*, 554 F.Supp.2d at 1081-82; *see also* ¶¶ 60, 64, 65-67. Therefore, the red flags relevant to a prominent part of Wells Fargo's business show the Director Defendants knew or should have known of the wrongful conduct, and demand is excused due to their conscious disregard of the conduct and warnings.

4. **Demand is Excused Because A Majority of Defendants Lack Independence or Have an Interest in Defending the Misconduct**

Directors are deemed "interested" for purposes of demand futility when they "receive a personal financial benefit from a transaction that is not equally shared by the stockholder" or where he or she is "beholden" to the subject of the claims and cannot base a decision on the "corporate merits of the subject before the board rather than extraneous considerations or influences." *Rales*, 634 A.2d at 936 (quoting *Aronson*, 473 A.2d at 815-16). "Independence is a fact-specific determination made in the context of a particular case." *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart* (Del. 2004) 845 A.2d 1040, 1049.

Defendants argue that receipt of substantial salaries or other compensation packages is insufficient, on its own, to establish director interestedness. WF Br. 14-15. Even if that is true, that is not what Plaintiffs allege. Plaintiffs allege that Defendants were financially motivated not to blow the whistle on this behavior, and why the amount, structure, and source of the compensation gave Defendants an incentive to encourage and/or conceal the illegal sales practices that were driving the Company's revenue and the Individual Defendants' compensation. *See, e.g.*, ¶¶ 17, 61-63, 64 ("Wells Fargo's senior management, including the Individual Defendants, knew of, encouraged, and closely monitored compliance with the 'Eight is Great' program. They regularly received updated cross-selling data and discussed the push for cross-selling to securities analysts. Indeed, the 'Eight is Great' cross-selling strategy was absolutely critical to the Company's bottom line and its ability to reach financial and other metrics used with its market analysts."); *see also* ¶¶ 65-67, 228; Compl. Exs. L-M. A reasonable inference can be drawn that the Company's financial success was directly related to the Board's financial success, and that is all that is required under the law. *See Rales*, 634 A.2d at 931.

In addition, the Complaint alleges that each Defendant was beholden to their positions on the Board, to their positions on various Board committees, and to ensuring the cash and stock awards they received maintained value such that they were unable to fairly and independently asses the Board's wrongdoing related to the illegal sales tactics:

- **Defendant Baker** has been a Board member since 2009, received over $361,000 in compensation in 2015 alone, is a member of the Board's Corporate Responsibility Committee, and is a member of the Board's Audit and Examination Committee which approved the Company's financial statements lauding the sales but failing to disclose that the practices were illicit (¶¶ 229-231);

- **Defendant Chao** has been a Board member since 2011 and received more than $291,000 from the Company in 2015 (¶¶ 232);

- **Defendant Chen** has been a Board member since 2006, received more than $279,000 in compensation in 2015, was involved in approving compensation packages and incentive awards for other officers and directors despite their involvement in the illegal sales, and is a member of the Board's Human Resources Committee (¶¶ 233-234);

- **Defendant Dean** has been a Board member since 2005, received over $346,000 from the Company in 2015, is a member of the Board's Corporate Responsibility Committee, is a member of the Board's Human Resources Committee, and was personally involved in authorizing compensation awarded to officers despite their involvement in the improper sales practices. Defendant Dean is also a member of the Board's Risk Committee, which failed to address warnings and ordered reforms, and is the Chair of the Board's Governance and Nominating Committee, which failed to adhere to the Company's own Corporate Governance Guidelines and Code of Ethics (¶¶ 235-239);

- **Defendant Duke** has been a member of the Board since 2015, received over $354,000 in 2015 alone, and is a member of the Board's Risk Committee but failed to heed warnings and ordered reforms related to the illegal sales practices (¶¶ 240-241);

- **Defendant Engel** has been a Board member since 1998, received over $331,000 from the Company in 2015, and is a member of the Human Resources committee that authorized variable compensation packages tied to performance and awarded to officers despite their involvement in the illegal sales tactics (¶¶ 242-243);

- **Defendant Hernandez** has been a Board member since 2003, received more than $402,000 in compensation in 2015, is a member of the Board's Corporate Responsibility Committee, and is the Chair of the Board's Risk Committee which ignored repeated warnings involving the illegal sales practices (¶¶ 244-246);

- **Defendant James** has been a Board member since 2009, received over $293,000 from the Company in 2015, is a member of the Board's Human Resources Committee, and was personally involved in approving officers' compensation packages which were tied to their performance and despite their involvement in the illicit sales tactics (¶¶ 247-248);

- **Defendant Milligan** has been a member of the Board since 1992, received over $352,000 in compensation in 2015, is a member of the Board's Corporate Responsibility Committee, is a member of the Board's Risk Committee which ignored warnings about the sales practices, and is a member of the Board's Governance and Nominating Committee but failed to adhere to the Company's Corporate Governance Guidelines and Code of Ethics (¶¶ 249-252);

- **Defendant Peña** received over $320,000 in compensation from the Company in 2015 alone, is a member of the Board's Corporate Responsibility Committee, is a member of the Board's Risk Committee yet ignored various warnings about the illegal tactics over the years, is a member of the Board's Audit and Examination Committee which approved the Company's financial statements without disclosing the illegal sales practices, and is a member of the Board's Governance and Nominating Committee but failed to abide by the Corporate Governance Guidelines and Code of Ethics (¶¶ 253-257);

- **Defendant Quigley** has been a Board member since 2013, received more than $382,000 from the Company in 2015, is a member of the Board's Risk Committee but ignored various warnings regarding the illegal practices, and is the Chair of the Board's Audit and Examination Committee and approved the Company's financial statements touting the sales practices but not disclosing the illegality thereof (¶¶ 258-260);

- **Defendant Sanger** is the Board's "Lead Director," received over $382,000 in compensation in 2015, is a member of the Board's Human Resources Committee, was personally involved in authorizing executive compensation that was tied to performance and despite executive involvement in the sales practices, is a member of the Board's Risk Committee and ignored multiple warnings about the sales practices, and is a member of the Board's Governance and Nominating Committee but failed to adhere to the Corporate Governance Guidelines and Code of Ethics (¶¶ 261-264);

- **Defendant Sloan** has held various executive positions during his tenure with the Company (CEO, CAO, COO, and CFO), had direct access to corporate communications, social responsibility, government relations, human resources, investor relations, and financial reporting, oversaw the Community Banking group, failed to report any of the illegal sales practices, personally benefitted from his own misconduct and from the misconduct of his fellow officers and Board members, and received more than $11 million in compensation for his performance (¶¶ 265-266);

- **Defendant Stumpf** is the former CEO of the Company, was a member of the Board, failed to disclose the illegal sales practices, benefitted from his own

breaches of fiduciary duty, and received over $19.3 million in performance-based compensation in 2015 alone (¶ 267);

- **Defendant Swenson** has been a Board member since 1998, received over $309,000 from the Company in 2015, is a member of the Board's Audit and Examination Committee and approved the Company's financial statements without disclosing the illegal sales practices, and is a member of the Board's Governance and Nominating Committee but failed to abide by the Corporate Governance Guidelines and the Code of Ethics (¶¶ 268-270); and

- **Defendant Vautrinot** has been a Board member since 2015, received more than $324,000 in compensation in 2015, and is a member of the Board's Audit and Examination Committee and approved the Company's financial statements but failed to disclose the illegality of the sales practices (¶¶ 271-272).

Such compensation-based allegations are sufficient to establish interestedness and can excuse a demand. *See Rales*, 634 A.2d at 936-37 (considering two directors interested where their compensation created reasonable doubt that they could act independently); *In re Veeco Instruments, Inc. Sec. Litig.* (S.D.N.Y. 2006) 434 F.Supp.2d 267, 275 (director's compensation made it improbable that he could perform his duties without being influenced by his personal interests).

B. Wells Fargo's Exculpatory Clause Does Not Impact Plaintiffs' Claims, Nor The Demand Futility Analysis

Wells Fargo notes that its charter exculpates the Director Defendants from liability for breach of fiduciary duty of care claims, pursuant to Delaware General Corporations Law section 102(b)(7). WF Br. at 8. However, even if true, Delaware law provides that an exculpatory clause "may properly be invoked and applied 'only where the factual basis for a claim ***solely*** implicates a violation of the duty of care.'" *Collins & Aikman Corp. v. Stockman* (D. Del. May 20, 2009) 2009 U.S. Dist. LEXIS 43472, at *64 (emphasis added) (quoting *Emerald Partners v. Berlin* (Del. 1999) 726 A.2d 1215, 1223-24). As the Chancery Court stated in *Alidina v. Internet.com Corp*. (Nov. 6, 2002) 2002 Del. Ch. LEXIS 156, at *28:

> [W]hen a duty of care breach is not the exclusive claim, a court may not dismiss based upon an exculpatory provision. Because the duty of loyalty is implicated in this case, the § 102(b)(7) provision cannot operate to negate plaintiffs' duty of care claim on a motion to dismiss.

Here, exculpation is not available to any Director Defendant because Plaintiffs assert non-

exculpated claims against all of them (*see, e.g.*, ¶¶ 222-224, 274: breach of the duties of loyalty, good faith, and fair dealing). Indeed, Defendants concede allegations of bad faith and intentional conduct are not covered by the exculpatory clause (WF Br. at 8), and the single case cited by Defendants reinforces this principle. *In re Autodesk, Inc. S'holder Deriv. Litig.* (N.D. Cal. Dec. 15, 2008) 2008 WL 523264 at *9-10 (failure-of-oversight theories are difficult to prove, but exculpatory provisions do not cover egregious breaches of fiduciary duties such as bad faith and self-dealing); *see also O'Reilly v. Transworld Healthcare, Inc.* (Del. Ch. 1999) 745 A.2d 902, 915 (defendants are not exculpated for bad faith and breach of duty of loyalty claims); *In re Lear Corp. S'holder Litig,* (Del. Ch. 2008) 967 A.2d 640, 648 (recognizing plaintiffs must also plead a non-exculpated claim); *Malpiede v. Townson* (Del. 2001) 780 A.2d 1075, 1093 (holding if a shareholder complaint unambiguously asserts only a due care claim, the complaint is dismissible once the corporation's Section 102(b)(7) provision is properly invoked); *Stone v. Ritter* (Del. 2006) 911 A.2d 362, 367 (recognizing § 102(b)(7) does not exculpate directors from liability for conduct not in good faith or breach of duty of loyalty); *In re Verifone Holdings, Inc. S'holder Deriv. Litig.* (N.D. Cal. May 26, 2009) 2009 WL 1458233 at *10 (same).

Moreover, exculpation is an affirmative defense that is improper to resolve at the pleading stage because of the fact-intensive nature of the inquiry. *See, e.g.*, *In re Tower Air, Inc.* (3d Cir. 2005) 416 F.3d 229, 242 (exculpatory statute is an affirmative defense not suitable for consideration in a motion to dismiss); *Sanders v. Wang* (Del. Ch. Nov. 8, 1999) 1999 WL 1044880 at *11 (same). Accordingly, Wells Fargo's exculpatory clause argument is inapposite.

C. Breach of Fiduciary Duty Is Adequately Alleged

The four Officer Defendants, Stumpf, Sloan,[8] Tolstedt, and Shrewsberry, demur to the First Cause of Action for Breach of Fiduciary Duty, and claim the Complaint fails to allege sufficient

[8] Defendant Sloan notes the inadvertent omission of his name from the Complaint's definition of the "Officer Defendants," and assumes for purposes of his demurrer that Plaintiffs intended to include him by responding to the stated grounds. Plaintiffs did intend to include Sloan as an Officer Defendant.

facts of breach.[9] However, Plaintiffs sufficiently alleged both breach of fiduciary duty of loyalty and care claims against the Officer Defendants.

First, as discussed at length above, Plaintiffs have alleged a claim for a breach of a duty of loyalty by showing that the Officer Defendants, as corporate fiduciaries, "utterly failed to implement any reporting or information system or controls; or … having implemented such a system or controls, consciously failed to monitor or oversee its operations." *Caremark*, 911 A.2d at 370. The Complaint provides detailed allegations of a culture of sales abuse that pervaded the Bank branch operations, and despite warnings, was not curtailed in any respect. The Officer Defendants do not—and, at the pleadings stage, cannot—seriously contest the shocking breadth of the illegal sales practice. Instead, they argue that they should escape liability because Plaintiffs—without the benefit of discovery—have been unable to plead direct evidence of a specific communication to the Officer Defendants showing their knowledge of the illegal practices.

That is not what the law requires. In *In re American International Group, Inc.* ("*AIG*"), then-Vice Chancellor Strine of the Delaware Chancery Court (now the Chief Justice of Delaware's Supreme Court) rejected a similar argument by senior corporate officers who ran a company with a culture pervaded by fraudulent practices. (Del. Ch. 2009) 965 A.2d 763, 777. There, as here, certain officers argued that the complaint was "less detailed" or had only "sparse references" to their "role[s] in the alleged misconduct." *Id.* at 776. The Delaware court rejected this argument, noting that the "problem for [the officers was] fundamental. At this stage, I must draw all reasonable inferences in favor of the plaintiffs. Each [officer] … was directly responsible for business units whose conduct was critical to the pervasive misconduct alleged in the Complaint. That misconduct was not isolated; it permeated [the corporation's] way of doing business." *Id.* at 777. Similarly, in *Countrywide*, the court held that plaintiffs had pled a valid *Caremark* claim, even "[t]hough the Complaint le[ft] many details unpled," where the complaint alleged a failure to take corrective action despite "widespread deviations from the underwriting policies and standards being committed by employees at all levels." (C.D. Cal. 2008) 554 F.Supp.2d 1044, 1082.

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[9] While the Director Defendants do not demur to the First Cause of Action for Breach of Fiduciary Duty, for the reasons set forth in Section III.B. above, the Complaint pleads non-exculpated breach of fiduciary duty of loyalty claims against them.

1 The same logic applies here. The Director of the CFPB described Wells Fargo's sales
2 practices as "fraudulent conduct . . . on a massive scale," that was not the "stray misconduct of just
3 a few bad apples" but rather "the consequences of a diseased orchard." ¶ 9. The scheme
4 ultimately affected two million customer accounts (¶¶ 4, 72, 74, 94), led to the termination of
5 5,300 employees (¶7), and dated back to at least 2011. *Id.* The misconduct was the inevitable and
6 predictable result of an over-aggressive cross-selling strategy—the "Eight is Great" program—that
7 was "so central to Wells Fargo that managers mentioned it 108 times at [a] … two-day investor
8 conference." ¶ 64. The Company's regulator issued a massive fine against the Company on the
9 basis of "a number of factors, including the bank's failure to develop and implement an effective
10 enterprise risk management program to detect and prevent the unsafe or unsound sales practices,
11 and the scope and duration of the practices." ¶ 85.
12 Notably, this pervasive fraud was allowed to continue even while the Company was being
13 forced to pay billions of dollars in regulatory penalties for similar misconduct. *See* ¶¶ 160–179
14 (detailing litany of fines, settlements, and regulatory penalties in the billions of dollars). *Compare*
15 *with In re Massey Energy Co.*, (Del. Ch. May 31, 2011) No. CIV.A. 5430-VCS, 2011 WL
16 2176479, at *19 (plaintiffs pled a sound good *Caremark* claim where "[a]lthough the defendants
17 point to a lot of motion by the independent directors, some of which resulted from a 2008 court-
18 ordered settlement, the plaintiffs in turn point to evidence creating a plausible inference that the
19 independent directors of Massey did just that—go through the motions—rather than make good
20 faith efforts to ensure that Massey cleaned up its act. Notably, the plaintiffs point to evidence that
21 in the wake of pleading guilty to criminal charges and suffering liability for numerous violations of
22 federal and state safety regulations, Massey mines continued to experience a troubling pattern of
23 major safety violations."); *In re Veeco Instruments, Inc. Sec. Litig.* (S.D.N.Y. 2006) 434 F.Supp.2d
24 267, 277-78 (plaintiffs stated a claim where "seven months after … alleged [export-control]
25 violations were discovered and brought to the Company's attention, the same employee reported a
26 second set of export violations," giving rise to inference that "[t]he Audit Committee permitted
27 additional violations to occur, either by completely disregarding the first report, or by establishing
28

procedures that were wholly inadequate and ineffective and that failed to protect the Company from potentially enormous liability.").

Here, each of the Officer Defendants is alleged to have been a senior executive with direct responsibility for preventing the type of illegal sales practices that pervaded the Company:

- **Defendant Stumpf**, as CEO and Chairman of the Board, admitted to feeling accountable for the sales practice violations and apologized for not taking action sooner. ¶¶ 3, 54, 117.

- **Defendant Sloan**, as CFO and COO, was "Stumpf's longtime lieutenant." Sloan also supervised the retail banking operations with Defendant Tolstedt. ¶ 18.[10]

- **Defendant Tolstedt**, as the head of Community Banking, oversaw the division in which the fraudulent, unethical, and illegal sales practices occurred. ¶ 58. Defendant Stumpf also confirmed that Tolstedt was responsible for this division and its compliance with the law. ¶ 119.

- **Defendant Shrewsberry**, as CFO of both the Company and the Bank, was responsible for the financial management of the bank, including accounting and control, financial planning and analysis, line of business finance functions, asset-liability management, investor relations, and enterprise expense and efficiency. ¶ 57. Shrewsberry is also a member of the Bank's Operating, Management, and Market Risk Committees. *Id.*

As in *AIG*, it is theoretically possible that "[a] cosmic wrong may have been done to the [Officer] Defendants, [who] were victimized by a large number of lower level employees who, despite good faith efforts at oversight and the use of internal controls by the [Officer] Defendants, were able to avoid detection and engage in widespread financial fraud." 965 A.2d at 777. But that theory is not plausible. At the pleading stage, "a plausible inference arises that [the Officer Defendants] themselves inspired and oversaw a business strategy premised in substantial part on the use of" fraudulent cross-selling. *Id.*

The shocking extent of the misconduct alleged in this case readily distinguishes the facts here from Defendants' key authorities applying the *Caremark* standard. In *Stone*, unlike here, the

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[10] Specifically, Sloan became the Company's President and COO in November 2015, and has served as CEO and a director on the Board since October 12, 2016. ¶53. He previously served as the Company's and Bank's Senior Executive Vice President, Wholesale Banking from May 2014 to November 2015, its Senior Executive Vice President and CFO from February 2011 to May 2014, and the Company's Senior Executive Vice President and CAO from September 2010 to February 2011. *Id.*

plaintiffs "acknowledge[d] that the directors neither knew [n]or should have known that violations of law were occurring,' *i.e.*, that there were no 'red flags' before the directors. 911 A.2d at 364 (cited in WF Br. at 2, 8, 9, 11; Shrewsberry Demurrer at 4, Stumpf Demurrer at 10, 11; Tolstedt Demurrer at 3). In *Reiter* (cited in WF Br. at 10, 11; Stumpf Demurrer at 10, 11, 12), unlike here, none of the purported "red flags" identified by the plaintiffs showed that "the Company's … controls and procedures actually had been found to violate statutory requirements at any time or that anyone within Capital One had engaged in fraudulent or criminal conduct. In other words, the core factual allegations of the Complaint do not amount to red flags of illegal conduct." Finally, in *Desimone v. Barrows*, unlike here, there was "no basis for an inference that knowledge of options backdating was widespread." (Del. Ch. 2007) 924 A.2d 908, 940 (cited in WF Br. at 2, 7, 8; Shrewsberry Demurrer at 4).

D. Abuse of Control and Gross Mismanagement Are Adequately Alleged

Plaintiffs also adequately allege that Defendants abused their control and grossly mismanaged the Company. *See* ¶¶ 21, 38, 286-293. While not technically labeled as separate causes of action under Delaware law, pleading abuse of control and gross mismanagement is valid. Delaware "common law standards thus govern the duties that directors and officers owe the corporation as well as claims such as those for 'reckless and gross mismanagement,' even if those claims are asserted separate and apart from claims of breach of fiduciary duty." *In re Citigroup Inc. S'holder Derivative Litig.* (Del. Ch. 2009) 964 A.2d 106, 115 n.6 (citing *Metro Commc'n Corp. BVI v. Advanced Mobilecomm Techs. Inc*. (Del. Ch. 2004) 854 A.2d 121, 155-57, and *Albert v. Alex. Brown Mgmt. Servs., Inc.* (Del. Super. Sept. 15, 2004) 2004 WL 2050527, at *6 ["[A] claim that a corporate manager acted with gross negligence is the same as a claim that she breached her fiduciary duty of care."]). Accordingly, Plaintiffs' abuse of control and gross mismanagement allegations can be properly analyzed under Delaware's breach of fiduciary duty standards.

E. Unjust Enrichment Is Adequately Alleged

The Complaint states a claim for unjust enrichment against the Individual Defendants. Delaware law has long recognized a cause of action for unjust enrichment. *See, e.g.*, *Fleer Corp.*

v. Topps Chewing Gum, Inc. (Del. 1988) 539 A.2d 1060, 1062; *Schock v. Nash* (Del. 1999) 732 A.2d 217, 232-33. Under Delaware law, unjust enrichment is the "unjust retention of a benefit to the loss of another, or the retention of money or property of another against the fundamental principles of justice or equity and good conscience." *Ryan v. Gifford* (Del. Ch. 2007) 918 A.2d 341, 361 (citation omitted).

"A defendant may be liable even when the defendant retaining the benefit is not a wrongdoer and even though he may have received [it] honestly in the first instance." *Id*. at 361 (citation omitted). Where it is reasonably conceivable that an officer or director retained "something of value…at the expense of the corporation and shareholders," an unjust enrichment claim should stand. *Id*; *see also Ghirardo v. Antonioli* (1996) 14 Cal.4th 39, 44; *Peterson v. Cellco Partnership* (2008) 164 Cal.App.4th 1583, 1593; *Lectrodryer v. SeoulBank* (2000) 77 Cal.App.4th 723, 726.

A claim for unjust enrichment under Delaware law includes five elements: "(1) an enrichment, (2) an impoverishment, (3) a relation between the enrichment and impoverishment, (4) the absence of justification, and (5) the absence of a remedy provided by law." *Calma on Behalf of Citrix Sys., Inc. v. Templeton* (Del. Ch. 2015) 114 A.3d 563, 591.[11]

The Complaint alleges that senior Wells Fargo management required employees to meet unrealistic sales targets so that the Company—and the Individual Defendants—could boast to the public markets that the Company was achieving continuous growth and the Individual Defendants could pay themselves lucrative compensation packages. *See, e.g.*, ¶ 7. Further, the Complaint alleges that the Company's revenues—artificially inflated as a result of Wells Fargo's years-long fraudulent scheme to deceive its own customers by creating millions of fake accounts and

[11] The majority of the Defendants merely state that because breach of fiduciary duty fails, unjust enrichment fails. Yet Delaware law recognizes the validity of unjust enrichment claims when premised on a breach of fiduciary duty. Specifically, at the pleading stage, an unjust enrichment claim that is premised on a breach of fiduciary duty claim—is frequently treated "in the same manner when resolving a motion to dismiss." *Calma, supra,* 114 A.3d at 591 (citing *Frank v. Elgamal* (Del. Ch. Mar. 10, 2014) 2014 WL 957550, at *31); *see also Dubroff v. Wren Hldgs., LLC* (Del. Ch. Oct. 28, 2011) 2011 WL 5137175, at *11 (denying a motion to dismiss a fiduciary duty claim and a duplicative unjust enrichment claim); *Espinoza v. Zuckerberg* (Del. Ch. 2015) 124 A.3d 47, 66-68 (unjust enrichment claim can proceed in action centered on breaches of fiduciary duty).

transactions—were the driving force behind compensation decisions for the Individual Defendants. *See generally* Complaint. As explained in the Complaint, Wells Fargo's focus on cross-selling through the "Eight is Great" program was absolutely critical to the Company's bottom line and its ability to reach financial and other metrics used by market analysts. ¶ 64. By reaching these benchmarks, the Individual Defendants ensured larger compensation packages for themselves. The OCC reached the same conclusion, detailing in the OCC Consent Orders that the "incentive compensation program and plans within the Community Bank Group… fostered the unsafe or unsound sales practices… and pressured Bank employees to sell Bank products not authorized by the customer." ¶ 87.

Each of the Individual Defendants received exorbitant compensation packages, in the form of executive bonuses, performance-based bonuses, and director fees during the same period in which—due to their failure of oversight—the Company was cheating its customers and exposing the Company to massive regulatory fines. These payments enriched the Individual Defendants at the expense of Wells Fargo. There can be no justification for these excessive pay packages, which the Individual Defendants knew were based on false metrics. California courts support disgorgement of profits where defendants have breached their fiduciary duty, as a "logical extension of the principle that public officials and other fiduciaries cannot profit by a breach of their duty." *County of San Bernardino v. Walsh* (2007) 158 Cal.App.4th 533, 542. The Complaint has therefore adequately pled a claim for unjust enrichment against the Individual Defendants.

F. Corporate Waste Is Adequately Alleged

The Complaint also states a claim for corporate waste. "Claims of corporate waste in California are based upon Delaware state law." *Swingless Golf Club Corp. v. Taylor* (N.D. Cal. 2009) 679 F.Supp.2d 1060, 1070-71. A claim of waste refers to "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." *White v. Panic* (Del. 2001) 783 A.2d 543, 554. To state a waste claim under Delaware law, "the plaintiff must 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." *Halpert v. Zhang*, (D. Del. 2013) 966

F.Supp.2d 406, 416 (internal citations omitted).[12] Courts have applied waste theory to compensation of directors and officers. *See Weiss v. Swanson*, (Del. Ch. 2008) 948 A.2d 433, 450 (motion to dismiss waste claim denied where compensation grants approved "without any valid corporate purpose").

As alleged in the Complaint, the members of the Board approved increases in pay, bonuses, and other compensation packages based on the Bank's performance and financial "strength," when in fact its revenues and performance were artificially inflated by the sales abuses. *See e.g.*, ¶¶ 99-104. Specifically, the Complaint alleges that at the recommendation of the Human Resources Committee (made up of Defendants Chen, Dean, Engel, James and Sanger), the Board approved millions of dollars in base pay to Defendants Stumpf, Sloan, Shrewsberry, and Tolstedt despite their involvement in the improper sales practices that subjected the Wells Fargo to financial and reputational harm. ¶¶ 234; 237; 243; 248; 262. Moreover, the Complaint alleges that the Human Resources Committee was directly involved in approving millions of dollars of bonuses, based largely on inflated performance, to be paid to Defendants Stumpf, Sloan, Shrewsberry, and Tolstedt. *See* ¶¶ 217-18; 234.

In approving these lucrative compensation packages to senior management, and refusing to take action to clawback such compensation, the Board permitted, and thus caused, the Company to waste its corporate assets. That the Board also concealed the conduct from regulators and investors and failed to implement any meaningful changes to end the illegal sales practices and/or eliminate employee incentives that encouraged such practices, even after specific warnings were brought to their attention, further demonstrates that their actions could not have been in good faith nor in the Company's best interest. Accordingly, Plaintiffs, on behalf of the Company, have sufficiently pled a cause of action for corporate waste.

[12] Critically, a "valid waste claim would deprive the board of the protection of the business judgment rule, and excuse demand." *Freedman v. Adams* (Del. 2013) 58 A.3d 414, 416.

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G. Violation of California Corporation Code Section 25402 for Insider Selling is Adequately Alleged

Defendants Stumpf, Tolstedt, Shrewsberry and Sloan assert two challenges to Plaintiffs' sixth cause of action for insider selling in violation of California Corporations Code section 25402 ("Section 25402"). ¶¶ 294-299. Neither challenge withstands scrutiny.

First, Defendants Shrewsbury and Sloan assert that, under the "internal affairs" doctrine, Plaintiffs must pursue their claims for insider selling under Delaware (and not California) law. Defendants fail to mention the seminal California case, *Friese v. Superior Court* (2005) 134 Cal.App.4th 693, which rejected this argument. As explained in *Friese*, the internal affairs doctrine is based on conflict of laws principles and does not apply to claims brought under "the Corporate Securities [Law of 1968] to protect California residents against fraud in the sale of securities of a foreign corporation." *Id.* at 708 (citing 9 Witkin, Summary of Cal. Law, *Corporations* 239, § 1006 (10th ed. 2005)); *Lidow v. Superior Court* (2012) 206 Cal.App.4th 351, 362 ("courts are less apt to apply the internal affairs doctrine when vital statewide interests are at stake, ***such as maintaining the integrity of California's security markets and protecting citizens from harmful conduct***") (emphasis added).

Friese also specifically distinguished Defendants' central case, *In re Sagent Tech.*, *Inc. Derv. Litig.* (N.D. Cal. 2003) 278 F.Supp.2d 1079, noting that it failed to discuss the history and purpose of California's insider trading prohibitions, or the long-standing California and U.S. Supreme Court authority that "consistently have found that a state's corporate securities laws are not subject to the internal affairs doctrine." 134 Cal.App.4th at 708.

Second, Defendants Tolstedt, Stumpf, Sloan and Shrewsberry, relying primarily on *In re Verisign, Inc. Deriv. Litig.* (N.D. Cal. 2007) 531 F.Supp.2d 1173, assert that Plaintiffs have failed to plead their Section 25402 claim with the requisite particularity. This argument also fails. To state a claim under Section 25402, a plaintiff need only allege that defendants purchased or sold shares while they had knowledge of material, non-public information. *See In re Finisar Corp. Deriv. Litig.* (N.D. Cal. July 12, 2012) 2012 WL 2873844, at *20-21. Plaintiffs allege each of these requirements.

Even if further detail was required, Plaintiffs' Complaint provides it. For example, with respect to knowledge and access to material, inside information, Plaintiffs describe the Individual Defendants' background and positions at Wells Fargo, giving them access to information that was not generally available to the public. ¶¶ 18, 54-53, 57-58, 265. The Complaint also alleges that "Wells Fargo's senior management, including the Individual Defendants, knew of, encouraged, and closely monitored compliance with" the cross-selling program, where the unlawful practices occurred. ¶ 64. Moreover, the Complaint alleges that: "Defendants STUMPF, TOLSTEDT, SHREWSBERRY and SLOAN … by virtue of their position and relationship with Wells Fargo, including as officers and/or directors, had access, directly or indirectly, to material information about Wells Fargo that was not generally available to the public, … including the Bank's illegal sales practices, as well as the warnings and complaints [regarding those practices] raised both internally by Bank employees and externally by Bank regulators." ¶ 295. Similarly, the Complaint explicitly alleges that the Officer Defendants "sold their Wells Fargo common stock in California at a time when they knew such material, non-public information gained from their relationship which would significantly affect the market price of that security…." ¶ 296. Exhibit M to the Complaint shows the exact dates and exact amounts of every challenged transaction.

Thus, the Complaint here sufficiently alleges that (1) these Selling Defendants sold their Wells Fargo shares (2) when they had knowledge of material, non-public information (i.e., the Company's unlawful sales practices) and (3) that they acquired this knowledge through their various high-level roles at Wells Fargo where they closely monitored the cross-selling programs in which unlawful sales practices occurred. Such allegations are sufficient to state a claim under Section 25402.[13]

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[13] Defendant Tolstedt additionally contends that the list of transactions in Exhibit M includes a trade she made on January 11, 2011 – outside of the five-year limitations period set forth in California Corporations Code section 25506(b). While this single transaction may have occurred outside of the limitations period, the other 34 transactions attributable to Defendant Tolstedt all occurred within the five-year limitations period.

IV. CONCLUSION

For the foregoing reasons, Plaintiffs respectfully request that the Court overrule Defendants' Demurrers in their entirety.

Dated: April 26, 2017

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