SUPERIOR COURT OF NEW JERSEY
APPELLATE DIVISION
DOCKET NO. A-1241-15T2

PAUL MEMO, derivatively on behalf of PRUDENTIAL FINANCIAL, INC.,

Plaintiffs-Appellants,

v.

JOHN R. STRANGFELD, JR., RICHARD J. CARBONE, PETER B. SAYRE, THOMAS J. BALTIMORE, JR., GORDON M. BETHUNE, GASTON CAPERTON, GILBERT F. CASELLAS, JAMES G. CULLEN, MARK B. GRIER, CONSTANCE J. HORNER, MARTINA HUND-MEJEAN, KARL J. KRAPEK, CHRISTINE A. POON, JAMES A. UNRUH and JON F. HANSON,

Defendants-Respondents,

and

PRUDENTIAL FINANCIAL, INC.,

Defendant.

Submitted March 7, 2017 – Decided August 21, 2017

Before Judges Messano, Espinosa and Suter.

On appeal from the Superior Court of New Jersey, Chancery Division, Essex County, Docket No. C-191-13.

Kantrowitz, Goldhamer & Graifman, PC and The Weisier Law Firm, PC, attorneys for appellants (Gary S. Graifman, on the brief).

Wong Fleming, and Edwin G. Schallert (Debevoise & Plimpton, LLP) of the New York Bar, admitted pro hac vice, attorneys for respondents (Daniel C. Fleming, on the brief; Mr. Schallet, of counsel and on the brief).

PER CURIAM

This appeal requires us to consider application of the business judgment rule, which "is embedded in American corporate law[,] . . . [and] 'protects a board of directors from being questioned or second-guessed on conduct of corporate affairs except in instances of fraud, self-dealing, or unconscionable conduct.'" In re PSE & G S'holder Litig., 173 N.J. 258, 276-77 (2002) (quoting Maul v. Kirkman, 270 N.J. Super. 596, 614 (App. Div. 1994)). "One recognized infringement on director autonomy is [a] shareholder-derivative action." Id. at 277; N.J.S.A. 14A:3-6.2. Before commencing such an action, the plaintiff must serve "a written demand . . . upon the corporation to take suitable action." N.J.S.A. 14A:3-6.3(a); see also R. 4:32-3 (setting forth prerequisites for filing a shareholder derivative complaint, including pre-suit demand by a plaintiff for the "desired" "action" by "managing directors or trustees").

In response to such a demand, the defendant managing directors and board members "may appoint a special litigation committee [(SLC)] to investigate whether the suit is in the best interest of the corporation." PSE & G, supra, 173 N.J. at 283 (citing Zapata Corp. v. Maldonado, 430 A.2d 779, 786 (Del. 1981). "Based on the committee's findings, the corporation may move for dismissal of the suit, although the corporation has the burden of proving the 'independence,' 'good faith,' and 'reasonableness' of the committee's investigation." Ibid. (quoting Zapata, supra, 430 A.2d at 788). Regardless whether an SLC is formed or not, our Court has adopted

> a modified business judgment rule that imposes an initial burden on a corporation to demonstrate that in deciding to reject or terminate a shareholder's suit the members of the board (1) were independent and disinterested, (2) acted in good faith and with due care in their investigation of the shareholder's allegations, and that (3) the board's decision was reasonable. All three elements must be satisfied.
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> [Id. (emphasis added) (citing In re PSE & G S'holder Litig., 315 N.J. Super. 323, 335 (Ch. Div. 1998)).]

In 2012, plaintiff Paul Memo, a shareholder of Prudential Financial, Inc. (Prudential), sent a pre-suit demand letter to John R. Strangfeld, Jr., Chairman of Prudential's Board of Directors (the Board) and its Chief Executive Officer (CEO),

asserting Prudential's management had breached their fiduciary duties. Plaintiff demanded the Board commence an independent internal investigation and bring a civil action against members of its management team. On March 12, 2013, the Board appointed three of its members to a "special evaluation committee" (SLC) to investigate plaintiff's allegations. The SLC interviewed two law firms, and chose Day Pitney, LLP (Day Pitney), to serve as its counsel.

On September 10, 2013, plaintiff filed a shareholder derivative action against Strangfeld, Richard J. Carbone, Prudential's Chief Financial Officer (CFO), Peter B. Sayre, its Principal Accounting Officer, and directors Thomas J. Baltimore, Jr., Gordon M. Bethune, Gaston Caperton, Gilbert F. Casellas, James G. Cullen, Mark B. Grier, Constance J. Horner, Martina Hund-Mejean, Karl J. Krapek, Christine A. Poon, James A. Unruh and Jon F. Hanson (collectively, defendants). Among other things, plaintiff asserted ten months had passed since he served the demand letter without any substantive response. Plaintiff further claimed the Board's inaction was a functional refusal of his demand and defendants breached their fiduciary duties to Prudential's shareholders.

Day Pitney notified plaintiff's counsel of the ongoing investigation. On March 24, 2014, the SLC issued its report.

Shortly thereafter, defendants moved to dismiss the complaint pursuant to Rule 4:6-2(e), but the court permitted limited discovery before ruling on the motion. See PSE & G, supra, 173 N.J. at 286 (permitting access to corporate records and discovery "limited to the narrow issue of what steps the directors took to inform themselves of the . . . demand and the reasonableness of its decision" (quoting PSE & G, supra, 315 N.J. Super. at 337)). In April 2015, plaintiff filed opposition to defendants' motion.

After considering oral argument, Judge Thomas Moore granted defendants' motion for reasons placed on the record in a comprehensive oral opinion. Judge Moore's October 6, 2015 order dismissed plaintiff's complaint with prejudice, and this appeal followed.

Plaintiff contends there were material factual disputes regarding the independence of the SLC members, particularly in light of a Day Pitney memo dated the same day the SLC issued its report. Plaintiff also argues Judge Moore erred in concluding as a matter of law that Day Pitney acted independently and the SLC's investigation was reasonable. Having considered these arguments in light of the record and applicable legal standards, we affirm.

I.

We briefly summarize some background to place plaintiff's claims in proper context.

Prudential provided financial management services and sold various investment products to the public, including life insurance policies and annuity contracts. In 2009, Verus Financial, LLC (Verus) notified the company that it would be examining Prudential's unclaimed property practices and compliance procedures on behalf of thirteen states.[1] In public filings, Prudential acknowledged the "audit may result in additional payments of abandoned funds to [United States] jurisdictions and to changes in the Company's practices and procedures for the identification of escheatable funds, which could impact claim payments and reserves, among other consequences."

In June 2011, the Board held a meeting that was attended by three members of the subsequently-formed SLC, during which the directors were given updates on the progress of the Verus audit. In November 2011, Prudential issued a press release announcing it increased its reserves by an additional $139 million, the lion's share of which was an acknowledgment of the company's decision to change its procedures for identifying deceased policy and contract holders, and the potential liability that might result. In December 2011, Prudential entered into a Global Resolution Agreement (GRA) with Verus, adopting modifications to its business

[1] The number of states continued to grow over ensuing years to a total of thirty-three.

practices and requiring Prudential to "identify and locate the beneficiaries" of all "policies and contracts active at any time since January 1, 1992 through December 31, 2010." Under the GRA, if a beneficiary could not be located, Prudential would remit all proceeds to the particular jurisdiction as unclaimed property subject to escheat.

Plaintiff claimed Prudential inappropriately held unclaimed property, resulting in the company posting stronger earnings than it should have. The disclosure of these irregularities resulted in significant decreases in the stock price.

Three directors, Baltimore, Hund-Mejean and Poon, comprised the SLC, with Poon elected as chair. All had extensive business experience, were more recent additions to the Board and had no direct involvement with managing the company. Each member completed a questionnaire consisting of twenty-five questions. The SLC report described a number of factors intended to ensure the committee's members were independent and personally disinterested in plaintiff's complaint.

The SLC concluded Prudential should take all appropriate actions to dismiss plaintiff's complaint, stating:

> Contrary to the claims in the Shareholder Letter and Shareholder Complaint, the SLC found that the Board and executive officers acted on an informed basis, with the input and advice of competent advisors, and in the good

> faith belief they were acting in the best interests of the corporation and its shareholders, generally and with respect to the periodic financial reports at issue. It found there existed reasonable systems for the flow of information to the Board and senior management, including with respect to the claims asserted in this matter. It found no evidence that the Board acted in other than good faith and in the best interests of the corporation and its shareholders, or that it consciously failed to oversee the operations of the Company or disregarded any red flags.

II.

Defendants moved to dismiss plaintiff's complaint for failure to state a claim for relief, Rule 4:6-2(e). The Rule plainly provides:

> If, on a motion to dismiss based on the defense numbered (e), matters outside the pleading are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided by R. 4:46, and all parties shall be given reasonable opportunity to present all material pertinent to such a motion.
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> [R. 4:6-2.]

In this case, after limited discovery regarding the appointment of the SLC, its counsel and its investigation, Judge Moore considered the issues presented by applying the standards set forth in Rule 4:46.

We consider the grant of summary judgment de novo, using the "same standard as the motion judge." Globe Motor Co. v. Igdalev,

225 N.J. 469, 479 (2016) (quoting Bhagat v. Bhagat, 217 N.J. 22, 38 (2014)).

> That standard mandates that summary judgment be granted "if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact challenged and that the moving party is entitled to a judgment or order as a matter of law."
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> [Templo Fuente De Vida Corp. v. Nat'l Union Fire Ins. Co., 224 N.J. 189, 199 (2016) (quoting R. 4:46-2(c)).]

Our "task is to determine whether a rational factfinder could resolve the alleged disputed issue in favor of the non-moving party." Perez v. Professionally Green, LLC, 215 N.J. 388, 405-06 (2013).

An opposing party must "do more than 'point[] to any fact in dispute' in order to defeat summary judgment." Globe Motor Co., supra, 225 N.J. at 479 (quoting Brill v. Guardian Life Ins. Co. of Am., 142 N.J. 520, 529 (1995)). If the opposing party

> offers . . . only facts which are immaterial or of an insubstantial nature, a mere scintilla, "fanciful, frivolous, gauzy or merely suspicious," he will not be heard to complain if the court grants summary judgment, taking as true the statement of uncontradicted facts in the papers relied upon by the moving party, such papers themselves not otherwise showing the existence of an issue of material fact.

> [Id. at 480 (quoting Brill, supra, 142 N.J. at 529) (quoting Judson v. Peoples Bank & Trust Co., 17 N.J. 67, 75 (1954)).]

Our review is limited to the record before Judge Moore. Lombardi v. Masso, 207 N.J. 517, 542 (2011).

We also review the trial court's decision to dismiss plaintiff's complaint under the modified business judgment rule de novo. PSE & G, supra, 173 N.J. at 287. Because defendants bear the burden of proof, we "must view the record with all legitimate inferences drawn in the [plaintiff]'s favor and decide whether a reasonable factfinder could determine that the [defendants] ha[ve] not met [their] burden of proof." Globe Motor, supra, 225 N.J. at 481. In other words, we must decide whether "the evidence is so one-sided that . . . [defendants] . . . must prevail as a matter of law." Brill, supra, 142 N.J. at 540 (quoting Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 252, 106 S. Ct. 2505, 2512, 91 L. Ed. 2d 202, 214 (1986)).

We review issues of law de novo and accord no deference to the trial judge's legal conclusions. Nicholas v. Mynster, 213 N.J. 463, 478 (2013). In this regard, we note that shortly after the SLC was formed in this case, on April 1, 2013, the Legislature enacted N.J.S.A. 14A:3-6.5, which "details various alternative procedures for the corporation to make an independent decision as to whether the derivative proceeding is in the best interests of

the corporation." Assembly Commerce and Economic Development Committee, Statement to A. 3123 (September 24, 2012); Senate Commerce Committee, Statement to A. 3123 (January 14, 2013).

N.J.S.A. 14A:3-6.5 permits a corporation, prior to seeking dismissal of a shareholder derivative action, to form a "committee . . . of one or more independent directors appointed by a majority vote of independent directors[,]" N.J.S.A. 14A:3-6.5(2)(b), and defines who is an independent director. N.J.S.A. 14A:3-6.5(7). The statute further provides that

> a derivative proceeding shall be dismissed by the court on motion by the corporation if the court finds that . . . [such a committee] has determined in good faith, after conducting a reasonable inquiry upon which its conclusions are based, that the maintenance of the derivative proceeding is not in the best interests of the corporation[.]
>
> [N.J.S.A. 14A:3-6.5(1)(a).]

Importantly, if the corporation follows such procedures, in certain circumstances, the statute shifts the burden of proof to the plaintiff. N.J.S.A. 14A:3-6.5(4) and (6).

In this case, neither party argued the statute applied, nor did Judge Moore discuss the statute. Neither party has cited the statute in its appellate brief. We assume, therefore, that it does not apply.

Moreover, for the present, we are bound by the Court's guidance as to how we should consider the impact, if any, that the formation of an SLC and its subsequent report to the Board has upon the modified business judgment standard. Although the issue was not squarely before it in PSE & G, supra, the Court said, "as a general framework for analysis, we will 'not differentiate between cases where a shareholder litigation committee investigated the demand and cases in which demand was refused by the board.'" 173 N.J. at 283 (quoting, PSE & G, supra, 315 N.J. Super. at 329 n.1). As a court of intermediate appellate jurisdiction, we defer to the Court's authority to adopt a different standard, particularly in light of the enactment of N.J.S.A. 14A:3-6.5. Riley v. Keenan, 406 N.J. Super. 281, 297 (App. Div.), certif. denied, 200 N.J. 207 (2009).

III.

We provide some additional context as we consider plaintiff's specific arguments.

In its report, the SLC detailed the selection process for its three members, which took into account, among other things: the SLC members' positions on the Board and Audit Committees, the "lack of any personal financial gain distinct from other shareholders from the activities alleged in the Shareholder Letter and Shareholder Complaint," the lack of personal interest in the

litigation and the lack of personal liability for the alleged activities. Counsel for the SLC reviewed additional information regarding relationships between SLC members, their families and affiliated organization, and Prudential, other directors and senior management.

The questionnaires completed by the SLC members contained two questions that focused on whether the member was involved in any discussions, prior to November 2011, as members of the "Audit Committee or Corporate Governance and Business Ethics Committee," regarding the company's treatment of unclaimed death benefits, escheatment and establishment of reserves (question 24), or whether the member was involved in the approval or review of Prudential's response to Verus' audits (question 25). All three SLC members answered in the negative. Day Pitney conducted face-to-face interviews with Hund-Mejean and Baltimore, but not Poon.

On March 24, 2014, the day the SLC filed its report, a Day Pitney intra-office memorandum indicated that during the investigation, SLC members "became aware of materials and information" showing "the Board . . . and the Audit Committee received updates from management regarding . . . the . . . Company's response to the Verus audit." The memo specifically cited questions 24 and 25 of the questionnaire, and stated "the

SLC members affirmatively wish to update their responses . . . to acknowledge and reflect these developments."

All three members of the SLC were deposed. Under oath, Poon specifically stated she did not want to update her answers on the questionnaire. In her deposition, Hund-Mejean reiterated her answers to questions 24 and 25. Baltimore testified in a manner that was consistent with the answers on his questionnaire.

Plaintiff argues the Day Pitney memo raises a genuine material factual dispute about the members' knowledge of and involvement in Prudential's practices and response to the Verus audit as it was ongoing, which should have foreclosed summary judgment on the critical issue of whether the SLC was "independent." We disagree.

"Directorial independence 'means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous consideration or influences.'" PSE & G, supra, 173 N.J. at 290 (quoting In re Prudential Ins. Co. Derivative Litig., 282 N.J. Super. 256, 276 (Ch. Div. 1995)). Judge Moore accepted the commonsense notion that as members of the Board, each SLC member would have received some information about the audit as it was ongoing. The judge focused on the deposition testimony of the three SLC members, which was unequivocal. We agree that the Day Pitney memorandum, standing alone, does not raise a material factual dispute about the knowledge each SLC

member possessed, or the actions or inactions they took as Board members, and therefore does not raise a material factual dispute about the SLC's independence and disinterestedness.

Plaintiff next contends material facts regarding Day Pitney's independence foreclosed the conclusion that it acted independently in providing counsel to the SLC. Specifically, plaintiff argues the law firm had previously represented a Board member, Krapek, in unrelated litigation, and it represented another corporation of which Poon served as a director.

Plaintiff's claims rest upon a table prepared by Day Pitney indicating its representation between January 1, 2010 and March 24, 2014, the date the SLC report was issued, of "Entities Associated With Individual Defendants" named in this litigation. In five instances, Day Pitney represented a client with which Krapek had some affiliation. It was apparently undisputed that the firm had earned more than $300,000 in fees for these representations, some of which ended before the SLC was formed, but that was a minute percentage of the firm's gross revenues.

Poon appeared as an associated defendant with respect to one Day Pitney client.[2] However, when specifically questioned at

[2] The chart listed three entities in one line item.

deposition about her directorship with the listed entities, Poon's answers were unclear.[3]

[3] The Day Pitney conflicts list included "Philips Electronics" as the entity with which Poon was affiliated. At deposition, she was asked about her membership on corporate boards, and responded:

> Q: And which boards might those be?
>
> A: I am a director of the public board called Regeneron.
>
> Q: Okay.
>
> A: I'm a director of the public board that's called Philips.
>
> . . . .
>
> Q: Okay. And with regard to Philips, would that be Philips Electric?
>
> A: Yes. Electronics.
>
> Q: I'm sorry. Electronics.
>
> A: Royal Philips is —
>
> Q: Okay. Royal Philips. And is there another name that begins with a K that's probably too long for me to say? Something like Koinklijke?
>
> A: Yes.
>
> Q: And there are also I believe some subsidiaries that you're affiliated with of Philips; is that correct?
>
> A: That's not correct.

Judge Moore concluded Day Pitney's prior representation of entities with which Krapek and Poon had some affiliation did not raise a genuine factual dispute about the law firm's independence. He cited In re Par Pharmaceutical, Inc. Derivative Litigation, 750 F. Supp. 641, 647 (S.D.N.Y. 1990), where the court held that an SLC must be represented by independent counsel. However, as Judge Moore noted, in that case, the same firm represented both the SLC and the corporation. Id. at 644.

Before us, plaintiff relies upon a portion of Justice Stein's concurring opinion in PSE & G, supra, 173 N.J. at 298-300, which discussed the importance of an SLC having independent counsel. However, there too, the law firm conducting the investigation of the plaintiffs' claim had previously represented the corporation in seeking an extension to respond to the complaint. Id. at 299-300.

Plaintiff cites to no other authority for the proposition that Day Pitney's representation of entities with which Krapek and Poon had some affiliation raised a material factual dispute regarding the independence of the firm's investigation of the complaint and the advice and counsel it rendered to the SLC.

Plaintiff also argues genuine material factual disputes exist regarding the reasonableness of the SLC's investigation. Specifically, he contends the SLC failed to conduct interviews of

key witnesses and never considered in its investigation the impact of another class action securities fraud complaint made against Prudential (the securities action). Defendants contend these issues were never raised before Judge Moore, and we agree that his oral decision does not specifically address these claims. Nonetheless, we conclude plaintiff's arguments lack any merit.

The Court described how we should consider whether the company conducted a reasonable investigation. "[T]he court's inquiry is not into the substantive decision of the board, but rather is into the procedures employed by the board in making its determination." PSE & G, supra, 173 N.J. at 291 (citation omitted). "In that regard, there is 'no prescribed procedure that a board must follow.'" Id. at 291-92 (quoting Levine v. Smith, 591 A.2d 194, 214 (Del. 1991), overruled on other grounds, Brehm v. Eisner, 746 A.2d 244 (Del. 2000)). "Nonetheless, the process should be such that a reviewing court can look to it and conclude confidently that it reflects a corporation's earnest attempt to investigate a shareholder's complaint." Id. at 292. "Stated differently, the inquiry is whether the 'investigation has been so restricted in scope, so shallow in execution, or otherwise so pro forma or half hearted as to constitute a pretext or sham[.]'" Ibid. (quoting Stoner v. Walsh, 772 F. Supp. 790, 806 (S.D.N.Y. 1991) (internal quotation marks and citation omitted)).

Plaintiff contends the SLC failed to interview Mark Grier, Prudential's Vice-Chairman who admittedly was responsible for a wide variety of corporate functions. The federal district court denied Prudential's motion to dismiss the complaint in the securities action that named Grier as a defendant. Plaintiff also contends the SLC failed to interview Verus or any government entity affected by Prudential's practices during the relevant period.

The Court has recognized that "[o]ne of a board's prerogatives . . . is 'to entrust its investigation to a law firm[.]'" PSE & G, supra, 173 N.J. at 292 (quoting Stepak v. Addison, 20 F.3d 398, 405 (11th Cir. 1994)). In City of Orlando Police Pension Fund v. Page, 970 F. Supp. 2d 1022 (N.D. Cal. 2013), the court said:

> [T]he [SLC] committee was not obligated to interview every potential witness identified by plaintiff (or any witnesses at all), nor does it suggest that plaintiff is somehow relieved of its burden to show that the un-interviewed individuals "had knowledge that was unique and unobtainable without those interviews, and how those interviews if taken would have altered the board's decision to refuse demand."
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> [Id. at 1032 (quoting Copeland v. Lane, No. 5:11-cv-01058 EJD, 2012 U.S. Dist. LEXIS 146815 (N.D. Cal. Oct. 10, 2012)).]

The SLC's report details the process employed to investigate plaintiff's claims. In part, Day Pitney reviewed more than eleven million pages of documents and interviewed twenty-nine witnesses.

Those interviewed included "current and former employees, officers, and members of the Board[;] [m]ultiple members of senior management . . . , as well as employees involved in the Company's disclosure process[,] and . . . representatives of multiple Board Committees." We can conclude with confidence that the investigation conducted by the SLC "reflects a corporation's earnest attempt to investigate a shareholder's complaint." PSE & G, supra, 173 N.J. at 292.

Plaintiff's final contention, that the SLC did not consider the securities action in reaching its conclusion, lacks sufficient merit to warrant discussion. R. 2:11-3(e)(1)(E). The SLC report actually cites other contemporaneously filed litigation against Prudential and other insurance companies regarding alleged failures to properly investigate deaths of policy holders.

Affirmed.