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Actions Seeking to Hold Merrill Officers Liable for Losses Rejected

BY MARK HAMBLETT

A FEDERAL judge has rejected two derivative actions seeking to hold Merrill Lynch officers and directors liable for enormous losses in the market for collateralized debt obligations and other mortgage-backed securities.

Southern District Judge Jed S. Rakoff yesterday disposed of the two "double-derivative" actions where shareholders were seeking to force Bank of America's board to initiate suit against top personnel at Merrill Lynch, which Bank of America acquired in a controversial merger amid the financial crisis in late 2008.

The dismissals come in the remaining cases before Judge Rakoff grouped under *In re Merrill Lynch & Co., Inc. Securities, Derivative and ERISA Litigation, Master File*: 07 Civ. 9633, as the securities and ERISA litigation have reached settlements that have been approved by the court.

In the consolidated cases under *Derivative Action*, 07 Civ. 9696, Judge Rakoff found the plaintiffs failed to show that the Bank of America board "was so involved in the underlying wrongdoing alleged in the *Derivative* complaint that it could not impartially consider a demand to pursue claims against the Merrill Lynch officers and directors."

And, in *Lambrecht v. O'Neal*, 09 Civ. 8259, Judge Rakoff said the plaintiffs had failed to meet their "considerable burden" of showing the Bank of America board's "decision not to bring a lawsuit against the Merrill Lynch officers and directors was made in bad faith or was based on an unreasonable investigation."

Judge Rakoff said he was not taking this step "lightly" because the allegations "describe the kind of risky behavior by high-ranking financiers that helped create the economic crisis from which so many Americans continue to suffer."

"But a derivative action is brought for the benefit of the company, and nothing here alleged in the complaints raises a reason to doubt that the board of the relevant company, BofA, was at all times fairly positioned to determine whether bringing an action against Merrill Lynch's former officers and directors was in the company's interest," he said.

Bank of America reached agreement on Sept. 14, 2008 to acquire Merrill Lynch in what plaintiffs in the derivative case called a "panic sale" brokered by the defendants, who were under pressure because of Merrill's billions of dollars in losses and write-downs in connection with collateralized debt obligations (CDOs).

Judge Rakoff

On Nov. 3, 2008, Merrill Lynch and BofA filed a joint proxy statement that failed to disclose even greater losses at Merrill Lynch and billions of dollars in bonuses to Merrill employees to be paid just before the Jan. 1, 2009 effective date of the merger.

Shareholders of Merrill Lynch and BofA approved the merger on Dec. 5, 2008.

When the losses became even more steep, BofA chief executive Kenneth Lewis told Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben Bernanke he would seek to cancel the merger through a "material change" clause in the deal, but they told him his board would be replaced if he tried to undo the deal and the merger was consummated on Jan. 1, 2009.

In *Derivative*, named plaintiff Miriam Loveman said that in July 2009, when her third amended complaint was filed, two of BofA's 16-member board had been on Merrill Lynch's pre-merger board and another 10 were on the BofA board that approved the merger, so they all had potential liability over $3.6 billion in year-end Merrill Lynch bonus payments as well as the huge fourth quarter losses.

While Ms. Loveman said it would be futile for her to demand the board take action because of these conflicts, Judge Rakoff disagreed.

"Plaintiff fails to explain why the BofA board would be incapable of performing a disinterested assessment of demand to sue the Merrill Lynch defendants for their pre-merger conduct (mostly relating to CDO underwritings undertaken in 2006-2007 and stock repurchases or sales also made in 2007)," he said. "The vast majority of the members of the BofA board at the time of the filing of the third amended complaint had no connection to this conduct and face no personal liability with respect to these claims."

In pressing to show that a demand would be futile, he said, it was insufficient to allege that BofA board members shared liability for wrongdoings such as the lack of disclosure on Merrill Lynch's late-2008 losses or the failure to invoke the "material change" clause.

"Indeed, were it otherwise, a plaintiff could always avoid having to make a demand in a double derivative situation by merely alleging that the members of the board of the acquiring company had some knowledge at the time of the acquisitions of the prior wrongdoings alleged against the officers and directors of the acquired company," he said.

He said Delaware law, which governs demand futility here, "requires far more than such bootstrapping."

The *Lambrecht* plaintiffs were different than those in *Derivative* only in that they made several demands on the various boards to take action.

But Judge Rakoff "easily dispensed" with their argument on the purported lack of independence by BofA board members.

"Similarly, Delaware law does not permit a plaintiff to overcome the business judgment rule simply by asserting that the substance of a board of director's decision was wrong," he said.

Bank of America had written a letter to plaintiffs offering several reasons why it was not going to press civil litigation against Merrill Lynch, including that "commencing the litigation outlined in your letters would impair Merrill Lynch's defenses in these various proceedings."

The *Lambrecht* plaintiffs asserted that the reasons offered by BofA for not bringing suit were "not credible."

But in Judge Rakoff's view, the plaintiffs' contention that BofA's reasons were not credible "does not implicate the reasonableness of the board's investigation and does not demonstrate of itself that the BofA board's refusal was made in bad faith."

The plaintiffs' "conclusory assertions," he said, were not enough to "overcome the presumption of the business judgment rule."

David Brower of Brower Piven and Matthew Miller at Cuneo, Gilbert & LaDuca in Washington D.C. were the lead lawyers for the plaintiffs.

Jay Kasner, Scott Musoff and Paul Lockwood of Skadden, Arps, Slate, Meagher & Flom represented Bank of America and Merrill Lynch.

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