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Corporate Governance Update

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WELLS FARGO MAY RECEIVE $320 MILLION FOR ACCOUNT SCANDAL

Just three weeks after Wells Fargo was ordered to pay a record $185 million penalty to state and federal regulators for opening up bank accounts without their customers' knowledge or authorization, many of the bank's shareholders filed a series of lawsuits alleging that the board of directors and certain officers breached their fiduciary duties to the bank. If the shareholders win these suits, the money they recover goes to the bank, not themselves. These shareholder suits were later consolidated in the Northern District Court of California.

Shareholders do not usually bring such shareholder derivative actions unless they believe that board members or management have breached certain fiduciary duties to the corporation. Each director and each corporate officer has a duty to adopt a corporate course of action which he or she in good faith believes to be in the best interests of the corporation and its shareholders. If the corporation's shareholders sue a director, then a court will apply the "business judgment rule." The "business judgment rule" requires a court to consider only whether a director has properly discharged his or her duty of care or duty of loyalty.

Wells Fargo's shareholders alleged that the board and certain officers breached their fiduciary duties. The shareholders noted that the board of directors and certain officers knew of the widespread fraud as far back as 2011 when then CEO John Stumpf discovered the fake accounts as part of an internal investigation. According to the complaint, various regulators, including the OCC, began investigations in 2012. In 2013, those regulators warned the board of directors and officers about the unlawful practices but according to the shareholders, the board and senior executives did not stop the unlawful behavior. The shareholders pointed out that even after being fined $185 million, the board of directors authorized a $124.6 million cash severance payment to the executive in charge of the fake account scandal.

Because of the suit, the bank filed a claim against its directors and officers (D&O) insurance policy. D&O insurance pays claims in the event an insured suffers a loss as a result of a legal action brought based on the directors' and officers' alleged wrongful acts. Most of the claims are alleged to have resulted from their failure to honor the duties of loyalty and care to the corporation. Intentional illegal acts typically are not covered under D&O insurance.

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On February 28, 2019, the parties filed a Stipulation and Agreement of Compromise, Settlement and Release (Stipulation) with the court and asked the judge to approve it. In the settlement, the parties agreed that the D&O insurance would pay $240 million to Wells Fargo. The parties also agreed to corporate governance changes and clawbacks for some executives, which would have a combined value to Wells Fargo of $80 million, bringing the total settlement value to $320 million. The bank must pay the shareholders' attorneys' fees, but this is still an unusual case in which a company receives monetary relief from its own scandal.

The judge has set a hearing on the proposed settlement for April 4, 2019. Contact the law firm for an update.