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IN THE SUPREME COURT OF THE STATE OF DELAWARE

ASBESTOS WORKERS LOCAL 42 PENSION FUND, derivatively on behalf of Nominal Defendant JPMORGAN CHASE & CO., a Delaware corporation, Plaintiff Below, Appellant, v. LINDA B. BAMMANN, *et al.*, Defendants Below, Appellees, and JPMORGAN CHASE & CO., Nominal Defendant Below, Appellee.	No. 322, 2015 Court Below: Court of Chancery of the State of Delaware, C.A. No. 9772-VCG PUBLIC VERSION

APPELLANT, ASBESTOS WORKERS LOCAL 42 PENSION FUND'S REPLY BRIEF

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PRELIMINARY STATEMENT

In their Answering Brief ("AB"), Defendants ask this Court to repeat the Court of Chancery's clear error by ruling that *collateral estoppel* bars Plaintiff from relitigating the issue of demand futility and that Plaintiff waived an argument, that various Agency Decisions preclude *collateral estoppel,* because this argument was raised at Oral Argument. Defendants' argument should be squarely rejected.

As explained in Plaintiff's Opening Brief, this Court should reverse the Court of Chancery's erroneous decisions on waiver and demand futility and reverse and vacate the Court of Chancery's Order for the following reasons:

First, the Court of Chancery erred in holding that Plaintiff was collaterally estopped from alleging demand futility by the decisions in the New York actions. Before instituting their litigation, Plaintiff engaged in an exhaustive books and records process under § 220 in a process which took more than a year and a half, and produced nearly 1500 of pages not reviewed by the plaintiffs in the New York actions. Allegations based on these additional documents [redacted] Moreover, unlike the New York Actions, Plaintiff has supported allegations of liability based on admissions of guilt in various Agency Decisions.

Second, the Court of Chancery erred in holding that the Plaintiff waived any argument that the Agency Decisions precluded *collateral estoppel*. The Court of Chancery misapprehended case law precedent from litigation that was at the appellant or post-trial briefing stages, and applied it to this action, where a motion to dismiss was being argued. The Agency Decisions were set forth in Plaintiff's complaint, and in the fact section of Plaintiff's Answering Brief on the Motion to Dismiss. Defendants had ample opportunity to reply, and could not have been surprised that a discussion of the Agency Decisions, of which the Court of Chancery could take judicial notice, took place during the hearing on the motion to dismiss.

Finally, the Court of Chancery erred in failing to reach a determination that demand upon the JPMorgan Board of Directors was futile. Plaintiff amply demonstrated, based on both materials produced pursuant to a § 220 demand, and the Agency Decisions, that demand on the JPMorgan board was a futile act, and demand was thus excused.

Reviewing *de novo*, this Court should vacate the Court of Chancery's May 22, 2015 Order.

ARGUMENT

I. THE COURT OF CHANCERY ERRED IN HOLDING THAT PLAINTIFF WAS COLLATERALLY ESTOPPED FROM ALLEGING DEMAND FUTILITY BY THE DECISIONS IN THE NEW YORK ACTIONS.

The Court of Chancery erred in determining that the outcomes of the New York Actions collaterally estopped Plaintiff from proceeding on the issue of demand futility. Plaintiff received material documents dated from as early as 2009 which were not produced in the New York Actions, and which show that: (a) t[redacted] Moreover, the Agency Decisions occurred after the NY Actions were filed and before Plaintiff's complaint was filed, so the allegations regarding the Agency Decisions were unique to Plaintiff's filing. This alone makes *collateral estoppel* impossible.

Thus, the issues in the New York Actions and Plaintiff's Complaint in the Court of Chancery are not identical, and Plaintiff is not collaterally estopped.

Defendants disagree over the interpretation of *Asbestos Workers Philadelphia Pension Fund v. Bell*, 43 Misc. 3d 1204(A) (N.Y. Sup. Ct. N.Y. Cnty. 2014). The

central issue, however, is whether the additional facts alleged by the Plaintiff can be said to create an issue that was not litigated in the prior New York Actions.

The Court in *Bell* found that previous actions "made no factual allegations that the Board granted unfettered authority to the A&LS Committee." *Id.* at *3. Thus, the Court held that "[c]ollateral estoppel does not apply in the present case because, although similar, the facts at issue here are not identical to the factual allegation in the prior attempts by JPMorgan shareholders to bring a derivative action against the Board arising out of RMBS premised on pre-suit demand futility." *Id.* Defendants characterize the new factual allegations presented in *Bell* as creating different alleged conduct (AB at p. 21). Regardless, the distinction is irrelevant in the present action because the new factual allegations raised by Plaintiff based on the additional documents easily create new conduct allegations equivalent to those perceived (by the Defendants) in the *Bell* matter.

For example, based on the document production, [redacted]

[redacted] *Id*.

[redacted] The Complaint, therefore, alleges with particularity, what the New York Actions omitted – [redacted] *Id*.

Moreover, based on the § 220 production, P[redacted]

- [redacted]

[redacted]

- [redacted]

Pertaining to specific (non) actions by month:

- [redacted]
- [redacted]

- [redacted]

[redacted]

[redacted]

[redacted]

[redacted]:

- [redacted]

a[redacted])

There are thus multiple examples of "different alleged conduct" contained in Plaintiff's allegations based on the additional document production.

Moreover, directly contrary to Defendants' argument otherwise (AB at p. 22), Plaintiff has alleged red flags that are not alleged in the New York Actions, based on documents that predate by over a year those documents cited to in the New York Actions. Defendants argue that the New York *Wandel* complaint alleges red flags from 2009 and 2010 (AB at p. 22). Not so. None of the *Wandel* paragraphs mentions 2009 or 2010, save a vague, unsupported reference in Paragraph 287, summarizing concerns that managers of the investment banking unit management had with the CIO developing risk profile but tying nothing to the Board. Such general allegations are nowhere close to the Plaintiff's Complaint's detailed red flags and particularized factual allegations. Nor could they have been, as the *Wandel* plaintiffs received none of the supplemental production.

These facts strongly support the conclusion that the Board Defendants face a substantial likelihood of personal liability and therefore demand is futile. For the foregoing reasons, Plaintiff respectfully requests that this Court reverse the Order of the Court of Chancery's dismissing Plaintiff's claims on *collateral estoppel* grounds.

II. THE COURT OF CHANCERY ERRED IN HOLDING THAT PLAINTIFF WAIVED ANY ARGUMENT THAT THE AGENCY DECISIONS PRECLUDED COLLATERAL ESTOPPEL

Plaintiff filed its Complaint after several regulatory agencies – the Federal Reserve, the OCC, the SEC, and the CFTC – conducted independent reviews and made findings of fact as to liability with regard to JPMorgan on precisely the issues that Plaintiff alleged in the Complaint. Plaintiff argued that *collateral estoppel* should not apply because these adverse Agency Decisions occurred after the filing of the New York Actions, and were included in its Complaint. (A189, ¶ 328; A262; A264-65; A759-60, Hr'g Tr. 41:12-42:17). The Court of Chancery held that Plaintiff raised this argument (that collateral estoppel should not apply because its Complaint was filed after five agency decisions adverse to the Company had been made) at Oral Argument for the first time and that therefore, the Plaintiff waived any argument that the Agency Decisions preclude *collateral estoppel*, relying on *Emerald Partners v. Berlin*, No. CIV.A. 9700, 2003 WL 21003437 (Del. Ch. Apr. 28, 2003), *aff'd*, 840 A.2d 641 (Del. 2003). *See* Opening Br. Ex. A at 48, n.162.

As discussed in Plaintiff's Opening Brief (at pp. 26-28), the Court of Chancery's reliance upon *Emerald Partners,* as a basis for finding waiver, is misplaced for a number of reasons involving the underlying statutory language, the stage of proceedings and, relatedly, the advanced number of years the *Emerald*

Partners matter has been litigated as opposed to the relatively early motion-to-dismiss stage here.

Defendants argue in their Answering Brief that "Delaware courts routinely apply waiver at the motion-to-dismiss stage" (AB at p. 27) but this statement misapprehends Plaintiff's argument.

To begin with, there are in reality only a few (Plaintiff's counsel found 5)[1] Delaware Court of Chancery motion-to-dismiss decisions which have applied waiver. All of these opinions rely on Delaware Supreme Court decisions *Emerald Partners* and *Murphy v. State*, 632 A.2d 1150, 1152 (1993) for the proposition that "issues not briefed are deemed waived."

Yet, the reliance of these five decisions on these cases is misplaced as it is in the present matter. *Emerald Partners*, *Murphy*, and their ilk (e.g., *Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135, 140 (Del. 1997)) rely on Delaware Supreme Court Rule 14 which specifically addresses the requirements of an appellant opening brief.

[1] The five cases include the three cases cited by Defendants and two more. Following the citations trail, *Emerald Partners* ultimately relies on *Murphy* which relies on Supreme Court Rule 14. Of the 114 cases which cite *Murphy* (and thus Supreme Court Rule 14) for the "issues not briefed are deemed waived" principle (*Murphy* Westlaw headnotes 3 and 4), 105 are Supreme Court decisions, only three are Court of Chancery decisions, and only two of those are on the motion-to-dismiss stage. Those two Delaware Chancery cases (*King v. VeriFone Holdings, Inc.*, 994 A.2d 354, 360 (Del. Ch. 2010); and *Thor Merritt Square, LLC v. Bayview Malls LLC*, C.A. No. 4480-VCP, 2010 WL 972776, at *5 (Del. Ch. Mar. 5, 2010), *rev'd*, 12 A.3d 1140 (Del. 2011)) rely on *Emerald Partners* and *Murphy*.

Murphy v. State, 632 A.2d 1150, 1152 (1993) includes a discussion of Supreme Court Rule 14, and states in part:

> The party appealing is generally entitled to frame the issues on appeal. The requirement that an appellant must raise and argue claims of error in the opening brief is founded on Supreme Court Rule 14. It provides that a brief must contain "[a] summary of argument, stating in separate numbered paragraphs *the legal propositions upon which each side relies,*" and that the body of the brief shall state "the merits of the argument." Supr.Ct.R. 14(b)(iv), (vi) (emphasis added).
>
> The failure to raise a legal issue in the text of the opening brief generally constitutes a waiver of that claim on appeal. *Stilwell v. Parsons,* Del.Supr., 145 A.2d 397, 402 (1958). *Accord Preservation Coalition, Inc. v. Pierce,* 667 F.2d 851, 861-62 (9th Cir.1982).

Both *Forsythe v. ESC Fund Mgmt. Co. (U.S.*), 2007 WL 2982247 (Del. Ch. Oct. 9, 2007) and *Tang Capital P'rs, LP v. Norton*, 2012 WL 3072347 (Del. Ch. July 27, 2012) for example (cited by Defendants in their Answering Brief (AB at p. 27, n.13)), relied solely on *Emerald Partners* for the "deemed waived" finding. And *Spring Real Estate, LLC v. Echo/RT* Holdings, LLC, 2013 WL 6916277 (Del. Ch. Dec. 31, 2013), also cited by Defendants, relies on *Emerald Partners* and *Forsythe* to support a finding of waiver.

In addition, starting with *In re IBP, Inc. Shareholders Litigation*, 789 A.2d 14, 62 (Del. Ch. 2001), there is a line of Delaware cases that find waiver in the context

of post-trial briefings.[2] *See, e.g.*, *In re Nine Sys. Corp. S'holders Litig.*, Consol. C.A. No. 3940-VCN, 2014 WL 4383127, at *46 (Del. Ch. Sept. 4, 2014) ("Plaintiffs also did not contest the post-January value of Company for purposes of the Recapitalization in their post-trial briefing, which means that the Plaintiffs waived this issue."); and *SinoMab Bioscience Ltd. v. Immunomedics, Inc*., C.A. No. 2471-VCS, 2009 WL 1707891, at *12 n.71 (Del. Ch. June 16, 2009) ("Immunomedics did not address those claims in post-trial briefing, and they are waived.").[3] Again, the Courts in these cases were assessing matters which were at advanced stages and involved multiple years of litigation.

These distinctions, regarding the stage of proceedings and the underlying legal basis for waiver, are important for a number of reasons including:

1) There is no statutory basis for the Court of Chancery to find that issues which are not raised in the briefing at the motion-to-dismiss stage are deemed waived;
2) On appeal, it is the plaintiff that chooses the matters to be appealed and

[2] Including *Mobilactive Media, LLC*, C.A. No. 5725-VCP, 2013 WL 297950 (Del. Ch. Jan 25, 2013) cited by Defendants in their Answering Brief (AB at p. 26).

[3] *See also Whittington v. Dragon Grp. L.L.C.*, C.A. No. 2291-VCP, 2009 WL 1743640, at *7 n.41 (Del. Ch. June 11, 2009) ("Frank failed, however, to renew his motion to exclude Katz's testimony in his post-trial briefing, and, therefore, has waived it."); *Barrett v. Am Country Holdings, Inc*., 951 A.2d 735, 745 n.33 (Del. Ch. 2008) ("In its post-trial opening brief, Kingsway brought up a related, but different argument."); *Horizon Personal Commc'ns, Inc. v. Sprint Corp*., C.A. No. 1518-N, 2006 WL 2337592, at *8 (Del. Ch. Aug. 4, 2006) ("Plaintiffs maintained this claim through trial, but abandoned it in post-trial briefing and at argument.").

hence the appropriate application of Supreme Court Rule 14 on appeals – moreover, this differs from a motion to dismiss briefing where plaintiff is responding to issues framed by the defendant;

3) The advanced stages of litigation in matters that (a) have been litigated for years, (b) are on appeal, and/or (c) are in a post-trial stage, indicate that the plaintiffs in those matters have had ample opportunity to raise issues – and this is not the situation at the motion to dismiss stage which occurs early in the litigation process;

4) In fact, to avoid injustice,[4] the Court of Chancery may choose to consider anything on the record in deciding a motion to dismiss - and this record includes discussion at the oral argument;

5) Moreover, even if the argument is not deemed to have been presented in the briefing, it is not a new claim – and Courts distinguish between allowing new arguments[5] and avoiding new claims.

The current case was at the Motion to Dismiss stage. Plaintiff pled facts

[4] Courts derive this exception from the Supreme Court's broad pronouncement in *Hormel v. Helvering*, 312 U.S. 552, 557 (1941) and *Singleton v. Wulff*, 428 U.S. 106, 121 (1976).

[5] The Supreme Court has distinguished between bringing a new claim before the court and bringing a new "argument" before the court. As the Supreme Court held in *Kamen v. Kemper Financial Services*, 500 U.S. 90 (1991), if a claim is timely raised, "the court is not limited to the particular legal theories advanced by the parties, but rather retains the independent power to identify and apply the proper construction of governing law." *Id.* at 99 (citing *Arcadia v. Ohio Power Co.*, 498 U.S. 73, 77 (1990)). Following *Kamen*, in cases like *Lebron v. National Railroad Passenger Corp.*, 513 U.S. 374, 382-83 (1995), the Court has determined that if a claim is properly before the court, the court may consider any number of new arguments or theories underlying that claim.

surrounding the Agency Decisions, briefed the Agency Decisions in the fact section of its brief opposing the motion to dismiss, incorporated all arguments by reference into the brief's conclusion, and raised the Agency Decisions at oral argument. The present matter is therefore significantly different from *Emerald Partners* where the litigation had been ongoing for many years and the plaintiff was faulted for not having previously raised an issue despite extensive briefing.

Defendants also argue that Plaintiff identifies nothing in the Agency decisions which implicate the Board (AB at p. 29). This is incorrect.

The Fed Consent Order in particular requires JPMorgan to institute corporate governance measures and must submit written plans addressing the deficiencies discovered by the FRBNY relating to Board oversight and risk management. This is pled in both the Complaint (A186-87, ¶ 322) and in Plaintiff's Opening Brief (at p. 30). Moreover, the OCC identified five main areas in which JPMorgan's processes had failed the Company, including inadequate oversight and governance, inadequate risk management processes and procedures, insufficient valuation control processes and procedures for credit derivatives trading, ineffective internal audit processes and procedures, and inadequate model risk management practices and procedures. This is pled in both the Complaint (A187, ¶ 323) and in Plaintiff's Opening Brief (at p. 30).

In addition, as part of the settlement with the SEC, JPMorgan was required to admit that it had misstated results in SEC filings, that its internal risk controls were ineffective, and that its disclosure controls were ineffective. This is pled in both the Complaint (A030, ¶22; A125-26, ¶197; A189, ¶328) and in Plaintiff's Opening Brief (pgs. 3, 8, 18, 29-30). Seven of the eleven current directors signed the Form 10-K for the Company for the years 2009 through 2011, and stand to be liable for material misstatements and omissions in those SEC filings. (A199 ¶351 & Opening Brief pg. 30). Although Defendants wish to portray the SEC's Cease and Desist Order as somehow exonerating the Board (AB pg. 29), in fact the order finds fault with JPMorgan's corporate governance and the failure to maintain disclosure controls and procedures necessary to ensure that information flows correctly so that disclosures are reliable. For example, the SEC found that:

> 1. Public companies are responsible for devising and maintaining a system of internal accounting controls sufficient to, among other things, provide reasonable assurances that transactions are recorded as necessary to permit preparation of reliable financial statements. In addition, the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") ***established important requirements for public companies and their management with respect to corporate governance and disclosure. For example, public companies are obligated to maintain disclosure controls and procedures that are designed to ensure that important information flows to the appropriate persons so that timely decisions can be made regarding disclosure in public filings***. Commission regulations implementing Sarbanes-Oxley therefore require management to evaluate on a quarterly basis the effectiveness of the company's disclosure controls and procedures

> and the company to disclose management's conclusion regarding their effectiveness in its quarterly filings.
>
> * * *
>
> 4. In the case of CIO, its VCG unit was unequipped to cope with the increase in the size and complexity of the SCP in early 2012, and did not function as an effective internal control in the first quarter of the year. ***The unit was understaffed, insufficiently supervised, and did not adequately document its actual price-testing policies.*** Moreover, the actual price-testing methodology employed by CIO-VCG in the first quarter of 2012 was subjective and insufficiently independent from the SCP traders, which enabled the traders to improperly influence the VCG process. In addition, during the first quarter of 2012, CIO-VCG failed to escalate to CIO and JPMorgan management significant information that management required in order to make informed decisions about disclosure of the firm's financial results for the first quarter of 2012. As a result, JPMorgan did not timely detect ***or effectively challenge questionable valuations by the SCP traders*** as the portfolio's losses accumulated in the first quarter of 2012 and publicly misstated its financial results for that period.
>
> * * *
>
> 5. JPMorgan's response to the CIO trading losses also was affected by inadequate communication between JPMorgan's Senior Management and the Audit Committee of JPMorgan's Board of Directors (the "Audit Committee").

(Plaintiff's Opening Br. Ex. B, pgs 1-2, emphasis added.)

Defendants' analogy to *Stone ex rel AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 366 (Del. 2006) (AB at p. 34) is unavailing because in that matter there were no admissions of guilt to FinCEN's determination that "'AmSouth's [AML compliance] program lacked adequate board and management oversight'" and the determinations of the other agencies in that matter did not involve any actions by the board.

JPMorgan, as part of the regulatory actions, admitted to misstating its financial results, lacking effective internal controls, concealing improper trading, misleading investors and regulators, and violating the securities laws. These admissions directly implicate the Board and support a substantial likelihood of personal liability.

III. THE COURT OF CHANCERY ERRED IN NOT REACHING A DETERMINATION THAT DEMAND UPON THE JPMORGAN BOARD WAS FUTILE

Both Plaintiff and Defendants agree that should this Court choose to address the merits of Plaintiff's demand-futility argument, it would decide the issue *de novo*. Defendants attempt to reduce the Plaintiff's allegations to a failure to monitor a single portfolio in a single business unit during a part of 2012 (AB at p. 33), but this is a vast misstatement of the case.

As Plaintiff argued in the Court of Chancery and as detailed above in section I, demand for action is excused here because as early as 2009, the JPMorgan Board was informed that the CIO was engaged in highly risky proprietary trading activity, yet repeatedly took no action to ensure that the protocols employed by the CIO were commensurate with the increased risk. Plaintiff seeks to hold JPMorgan's directors personally liable for ignoring these multiple red flags and failing to act upon them. Moreover, JPMorgan has admitted guilt in multiple Agency Decisions which implicate the Board. These pleadings fully satisfy the particularized pleading requirement of Rule 23.1 as well as the Rule 12(b)(6) standard.

Defendants also argue that *In re American International Group, Inc.*, 965 A.2d 763, 776 (Del. Ch. 2009), *aff'd sub nom*. *Teachers' Retirement System of Louisiana v. PricewaterhouseCoopers LLP*, 11 A.3d 228 (Del. 2011) does not apply in the present context because *AIG* involved illegal conduct which is not alleged in

the present matter. This is incorrect. As discussed above, illegal conduct has not only been alleged by Plaintiff, JPMorgan has admitted guilt over this illegal conduct.

For the foregoing reasons, Plaintiff respectfully requests that this Court hold that Plaintiff has adequately alleged that demand for action is futile on the JPMorgan Board.

CONCLUSION

For all of the foregoing reasons, Plaintiff requests this Court reverse the Court of Chancery's judgment against Plaintiff in its entirety.

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CERTIFICATE OF SERVICE

I, Carmella P. Keener, do hereby certify that on this 13th day of October 2015, I caused:

1. [PUBLIC VERSION] Appellant, Asbestos Workers Local 42 Pension Fund's Reply Brief; and

2. this Certificate of Service

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