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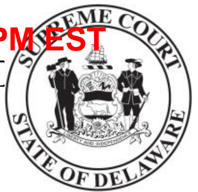

PUBLIC VERSIO[N]

SUPREME COURT OF THE STATE OF DELAWARE

CITY OF PROVIDENCE, RHODE ISLAND, derivatively on behalf of JPMORGAN CHASE & CO., Plaintiff Below-Appellant, v. JAMES DIMON, *et al.*, Defendants Below-Appellees, -and- JPMORGAN CHASE & CO., Nominal Defendant Below-Appellee	No. 465, 2015 Court Below: Court of Chancery of the State of Delaware, Civil Action No. 9692-VCP

APPELLANT THE CITY OF PROVIDENCE, RHODE ISLAND'S CORRECTED OPENING BRIEF

Dated: November 6, 2015
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Nature of the Proceedings

Beginning on August 25, 2011, and ending on January 7, 2014, Nominal Defendant JPMorgan Chase & Co. ("JPMC" or the "Company") entered into a series of administrative agreements with the Department of the Treasury's Office of Foreign Assets Control ("OFAC") and Office of the Comptroller of the Currency ("OCC"), and the Board of Governors of the Federal Reserve System (the "Fed"). These agreements either exclusively or primarily concerned alleged deficiencies in JPMC's compliance with U.S. economic sanctions laws and associated anti-money laundering/Bank Secrecy Act ("AML/BSA") violations. JPMC agreed to pay the federal government a total of $438.3 million in connection with these alleged economic sanctions laws/AML/BSA violations. As a separate matter, on January 6, 2014, JPMC and the U.S. Attorney for the Southern District of New York entered into a Deferred Prosecution Agreement ("DPA") involving two counts of AML/BSA violations regarding the mega-Ponzi scheme orchestrated by Bernard L. Madoff ("Madoff") and his firm, Bernard L. Madoff Investment Securities LLC ("BMIS"). Under the DPA, JPMC agreed, among other things, to pay a $1.7 billion forfeiture to the government to be redistributed to Madoff's victims. A fast-filed derivative action against the current Defendants based exclusively on the DPA and the allegations therein was subsequently dismissed on

demand futility grounds in *Central Laborers' Pension Fund v. Dimon*, 2014 U.S. Dist. LEXIS 100874 (S.D.N.Y. July 23, 2014) ("*Central Laborers*").

The present derivative action, which was filed after Plaintiff made a books and records demand, was based on damage to the Company caused by its economic sanctions compliance failures and associated AML/BSA issues resulting from Defendants' breaches of their fiduciary duties, which were separate and distinct from the Madoff scandal and its AML/BSA violations, the forfeiture, and any breaches of fiduciary duties by Defendants associated therewith. Nevertheless, on July 29, 2015, the trial court granted Defendants' motion to dismiss on the sole basis that Plaintiff's claims were barred under New York *res judicata* principles as a result of the dismissal of the *Central Laborers'* action. *City of Providence v. Dimon*, 2015 Del. Ch. LEXIS 195 (Del. Ch. July 29, 2015).[1]

Plaintiff brings this timely appeal of the trial court's dismissal of its Complaint.

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[1] A copy of the Memorandum Opinion is attached hereto as Exhibit A. For ease of reference, citations shall be to the Memorandum Opinion as published in Lexis.

Summary of the Argument

On May 23, 2014, Plaintiff Below-Appellant The City of Providence, Rhode Island ("Plaintiff") filed a shareholder derivative action (the "Complaint") against certain current and former directors and officers of JPMC for breach of their fiduciary duty of oversight as a result of their knowing failure to stop or remedy repeated violations of U.S. economic sanctions law and associated AML/BSA requirements. In this appeal, Plaintiff seeks relief from the Court of Chancery's Order of July 29, 2015 dismissing Plaintiff's shareholder derivative action in its entirety with prejudice on grounds of *res judicata*.

1. The key issue in this appeal is whether the trial court properly determined that the dismissal of a complaint in a separate action – *Central Laborers'* – bars Plaintiff's Complaint because "the claims [Plaintiff] advances arise out of the same series of transactions that were at issue in the Central Laborers' Action." 2015 Del. Ch. LEXIS 195, at *26. As explained below, the trial court should be reversed.

2. The facts in the record unequivocally show that the claims alleged in *Central Laborers'* focused exclusively on alleged wrongful conduct concerning Madoff's Ponzi scheme. In sharp contrast, Plaintiff's Complaint alleged with particularity that

The core claims alleged in the Complaint concern breaches of fiduciary duties by Defendants regarding the Company's willful and knowing violations of U.S. economic sanctions[2] and related AML/BSA compliance failures. A comparison of the Complaint and the *Central Laborers'* complaint shows that the claims alleged in the Complaint involve transactions that have nothing to do with Madoff. *Cf.* Complaint (A-22) with the *Central Laborers'* complaint (A-331).

3. Under New York law, which applies here, *res judicata* only applies where the claims sought to be precluded are based on the "same transaction or series of transactions." *In re Estate of Hunter*, 827 N.E.2d 269, 274 (N.Y. 2005). Plaintiff's Complaint alleged that Defendants breached their oversight duties with respect to the Company's failure to comply with U.S. economic sanctions laws,

[2] "Economic sanctions" means U.S. laws and regulations that prohibit certain transactions with countries and entities having connections to terrorism and money laundering, such as Iran, Cuba, and Sudan. They include the Cuban Assets Control Regulations ("CACR"), 31 C.F.R. § 515.201; Weapons of Mass Destruction Proliferators Sanctions Regulations ("WMDPSR"), 31 C.F.R. § 544.201; Executive Order 13382, 'Blocking Property of Weapons of Mass Destruction Proliferators and Their Supporters; the Global Terrorism Sanctions Regulations, 31 C.F.R. § 594.201; the Iranian Transactions Regulations, 31 C.F.R. §§ 560.204, 560.206, 560.208; the Sudanese Sanctions Regulations ("SSR"), 31 C.F.R. §§ 538.201, 538.205; the Former Liberian Regime of Charles Taylor Sanctions Regulations, 31 C.F.R. § 593.201; and the Reporting, Procedures and Penalties Regulations, 31 C.F.R. § 501.602 (collectively, "U.S. economic sanctions" laws or "economic sanctions laws"). A-2270.

including associated BSA/AML violations, that occurred both before and after Madoff was arrested, involved more entities within the Company and different types of transactions and violations, and resulted in penalties imposed on the Company that were completely unrelated Madoff and his Ponzi scheme. The trial court's application of New York's *res judicata* principles thus was overbroad. Therefore, the trial court's dismissal of the present Action should be reversed and the matter remanded for further proceedings.

Statement of Facts

A. The Parties

Plaintiff the City of Providence, Rhode Island is a beneficial owner of JPMC common stock, and has continuously owned JPMC stock since January 1, 2005. A-31 (¶ 15).[3] Plaintiff served a demand for books and records on JPMC's Board, and over the course of approximately 12 months, JPMC produced approximately 5,000 pages of books and records. A-31, 109 (¶¶ 16, 221).

Nominal Defendant Below-Appellee JPMC is a Delaware corporation headquartered in New York, New York. A-31 (¶ 17). Defendant Below-Appellee James Dimon is the Company's Chairman and Chief Executive Officer ("CEO"). A-31-32 (¶ 18). Defendants Below-Appellees James A. Bell, Crandall C. Bowles, Stephen B. Burke, David M. Cote, James C. Crown, Timothy P. Flynn, Ellen V. Futter, Laban P. Jackson, Jr. Robert I. Lipp, David C. Novak, Lee R. Raymond and William C. Weldon are all current or former directors of JPMC. A-32-34 (¶¶ 19-25; 27-31). Appellee Martha Gallo served as Head of Global Compliance and Regulatory Management between 2011 and 2013, and served as Executive Vice President and General Auditor between 2006 and 2011. A-34 (¶ 32).[4]

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[3] Citations to "¶" refer to corresponding paragraphs in the Complaint.

[4] William H. Gray was named as a Defendant in the action below, but was subsequently dismissed by Plaintiff. William Langford ("Langford") and Nina Nichols ("Nichols") were named as Defendants in the action below, but were

B. The *City of Providence* Complaint

The core claims alleged in the Complaint concern breaches of fiduciary duties by Defendants regarding JPMC's willful and knowing violations of U.S. economic sanctions, and JPMC's AML/BSA compliance failures. OFAC "administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals against targeted foreign countries, terrorists, international narcotics traffickers, and those engaged in activities related to the proliferation of weapons of mass destruction," hardly the type of conduct in which Madoff was engaged. A-42 (¶ 64).[5] Moreover, while OFAC's regulations and the BSA share common national security concerns, "OFAC requirements *are separate and distinct* from the BSA." *Id.* (¶ 66) (emphasis added).

The Complaint alleged JPMC's BSA/AML deficiencies, and Defendants' knowledge thereof, in detail in the context of terrorist financing and money laundering for illegal drug cartels. By way of introduction, the Complaint said:

Money laundering and terrorist financing are financial crimes with

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dismissed with prejudice for lack of personal jurisdiction. 2015 Del. Ch. LEXIS 195, at *4-5 n.2. Plaintiff is not appealing the dismissal of Langford and Nichols.

[5] *See also* http://www.treasury.gov/about/organizational-structure/offices/Pages/Office-of-Foreign-Assets-Control.aspx (OFAC "administers and enforces economic and trade sanctions based on US foreign policy and national security goals against targeted foreign countries and regimes, terrorists, international narcotics traffickers, those engaged in activities related to the proliferation of weapons of mass destruction, and other threats to the national security, foreign policy or economy of the United States.") (last viewed Oct. 19, 2015).

> potentially devastating social and financial effects. From the profits of the narcotics trafficker to the assets looted from government coffers by dishonest foreign officials, criminal proceeds have the power to corrupt and ultimately destabilize communities or entire economies. Terrorist networks are able to facilitate their activities if they have financial means and access to the financial system. In both money laundering and terrorist financing, criminals can exploit loopholes and other weaknesses in the legitimate financial system to launder criminal proceeds, finance terrorism, or conduct other illegal activities, and, ultimately, hide the actual purpose of their activity.
>
> As explained below, U.S. law requires banking organizations to develop, implement, and maintain effective AML programs that *address the strategies of money launderers and terrorists who attempt to gain access to the U.S. financial system.* A sound BSA/AML compliance program is critical in deterring and preventing these types of activities at, or through, banks and other financial institutions.

A-36 (¶¶ 39-40) (emphasis added). These allegations put the trial court on notice that the present case concerned, for example, breaches of fiduciary duties associated with JPMC's laundering of funds for Iran *in violation of U.S. economic sanctions laws* rather than enabling Madoff's Ponzi scheme, two very different types of transactions involving violations of different laws and different segments, subsidiaries, and employees of the Company. Nevertheless, the trial court found them to be the same for *res judicata* purposes.[6]

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[6] Plaintiff is not seeking to recover on the Company's behalf the $1.7 billion forfeiture agreed to by JPMC in the DPA or any other damage to the Company flowing directly from the DPA. Additionally, Plaintiff is not challenging the substantive *res judicata* effect of the dismissal of the derivative claims against the Defendants regarding the DPA on demand futility grounds in *Central Laborers'*, nor is it claiming that plaintiff's representation in *Central Laborers'* was

The Complaint alleged that [redacted]

A-55 (¶ 98) (emphasis added). The Complaint further alleged numerous violations of economic sanctions regulations promulgated by OFAC – none of which have anything to do with Madoff – such as:

- From on or about December 12, 2005, to on or about March 31, 2006, JP Morgan processed 1,711 electronic funds transfers in which the Cuban Government or a Cuban national had an interest, in the aggregate amount of $178,530,954.27, in violation of the prohibition against dealing in property in which Cuba or a Cuban national has an interest, 31 C.F.R. § 515.201 [part of the CACR];
- On or about April 27, 2006, JPMC processed or rejected four electronic funds transfers, in the aggregate amount of €65,000 (approximately $80,596.75), for the benefit of Al-Aqsa Foundation, an entity designated pursuant to E.O. 13224[7] of September 23, 2001, in violation of the prohibition against dealing in property and interests in property of persons designated pursuant to E.O. 13224, 31 C.F.R § 594.201;

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inadequate because its counsel hastily filed a lengthy complaint on a complex matter without first making a books and records demand on the Company.

[7] Executive Order 13224 authorizes the Department of the Treasury to designate and block the assets of foreign individuals and entities that commit, or pose a significant risk of committing, acts of terrorism.

- On or about May 24, 2006, JPMC processed a 32,000 ounce transfer of gold bullion worth approximately $20,560,000 for the benefit of the Government of Iran in apparent violation of the prohibition against the "exportation . . . directly or indirectly, from the United States, or by a United States person . . . of any . . . services to Iran or the Government of Iran," 31 C.F.R. § 560.204;
- On or about January 29, 2008, JPMC processed a $79,308.80 transaction, for the benefit of the Government of Sudan and/or persons in Sudan, in violation of the prohibitions against, respectively, (1) dealing in property or interests in property of the Government of Sudan that come within the United States, 31 C.F.R. § 538.201(a), and (2) the "exportation or reexportation, directly or indirectly, to Sudan of any goods . . . or services from the United States or by a United States person," 31 C.F.R. § 538.205 [the SSR];
- On April 24, 2009, [*after Madoff had been arrested*], JPMC advised and confirmed a $2,707,432 letter of credit in which the underlying transaction involved a vessel identified by OFAC as blocked due to its affiliation with the Islamic Republic of Iran Shipping Lines ("IRISL"), and a $79,308 letter of credit on January 29, 2008, involving goods destined for Sudan, a transaction that violated the WMDPSR and SSR;
-

A-56-59, 67, 72, 78 (¶¶ 102, 107-08, 131, 147, 162).

The Complaint alleged in detail, using the documents Plaintiff received from

its books and records demand: (1) how the economic sanctions and related AML/BSA violations were pervasive throughout various JPMC domestic and international divisions rather than concentrated in its Investment Bank's Broker-Dealer Banking Group, which was the case for the Madoff AML/BSA violations; and (2) that [redacted] A-118 (¶ 243) (emphasis added).

As illustrated above, the Complaint in the present Action has virtually no connection with Madoff or BMIS. In fact, the Complaint, which was drafted following the receipt of approximately 5,000 pages of documents in response to a books and records demand that did not request materials related to Madoff or BMIS, mentions Madoff in exactly *two* of its 296 paragraphs:

[redacted]

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8 [redacted]

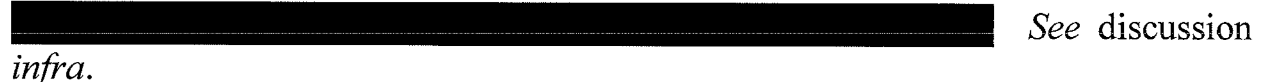
* * *

> Further, between 2006 and 2008, JP Morgan created, sold and made a secondary market for structured products that provided customers access to Madoff's investment strategy through several "feeder funds." Prior to Bernard L. Madoff's arrest, the Company developed concerns about Madoff and a distributor of Madoff-linked investments created by the Company. These concerns caused the Company's London branch to file a suspicious activity report with the United Kingdom's Serious Organised Crime Agency on October 29, 2008. Aware that Madoff was a client of the Company in the U.S., U.K.-based Company employees conveyed these concerns to U.S.-based employees. Despite the fact that these concerns caused JP Morgan to file a suspicious activity report in the U.K., the Company did not file a SAR in the U.S. based on these concerns. The failure to file a SAR on this activity and to do so timely is significant and a violation of 12 C.F.R. § 21.11(c) and (d).[9]

A-71, 115-16 (¶¶ 143, 230).

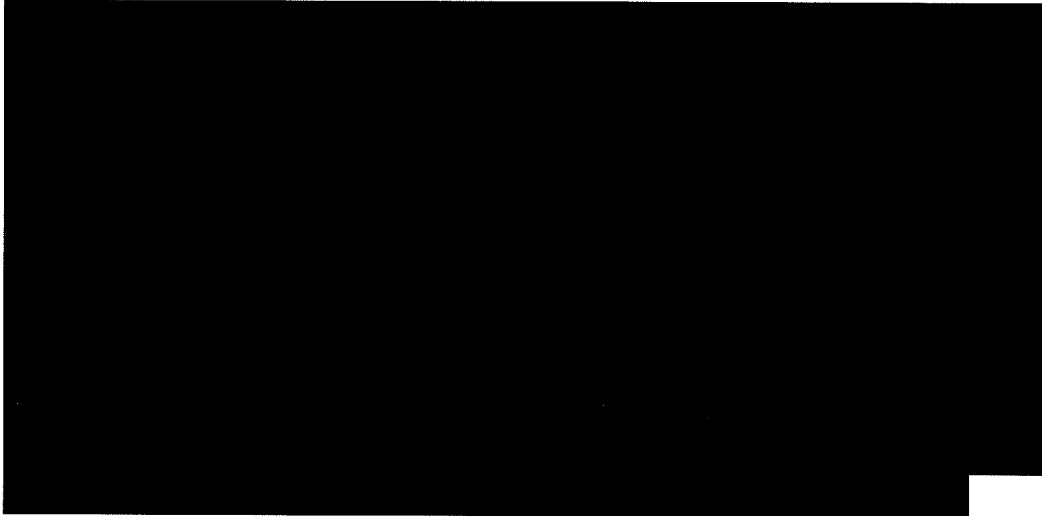
1. *The OFAC Settlement Agreement*

On August 25, 2011, OFAC and JPMC entered into a Settlement Agreement covering nine separate alleged *economic sanctions* violations. A-88-89, 139-46 (¶¶ 183-86 & Ex. A). While not admitting any of OFAC's allegations, JPMC agreed to pay the Department of the Treasury the sum of $88.3 million. Plaintiff's derivative claim against Defendants for this amount, *which had nothing to do with Madoff or BMIS,* was barred by the trial court's overly broad interpretation of the *res judicata* effect of *Central Laborers'*.

 *See* discussion *infra*.

[9] The DPA also is mentioned at Paragraph 11 of the Complaint without reference to Madoff or BMIS. A-30.

The Complaint alleges that JPMC's economic sanctions compliance deficiencies continued years after Madoff's criminal endeavors ended and involved numerous transactions that have nothing to do with Madoff. For example:



A-91-92 (¶ 192).

2. *The 2013 OCC Consent Order*

On January 14, 2013, JPMC entered into separate consent orders with the OCC and the Fed, both of which have supervisory authority over JPMC. A-107-09, 147-92 (¶¶ 215-20 & Exs. B-C). The OCC found "critical deficiencies in the elements of the Bank's BSA/AML compliance program," such as "[t]he Bank does not have enterprise-wide policies and procedures to ensure that *foreign branch suspicious activity* involving customers of other bank branches is effectively communicated to other affected branch locations and applicable AML operations staff. The Bank also does not have enterprise-wide policies and procedures to

ensure that on a risk basis, customer transactions at *foreign branch locations* can be assessed, aggregated, and monitored." A-150 (Complaint Ex. B Art. I ¶ (4)(d)) (emphasis added). Further, the OCC determined that *"[t]he Bank's internal controls, including filtering processes and independent testing, with respect to . . . OFAC . . . compliance are inadequate."* A-151 (*Id.* at ¶ (6)) (emphasis added).[10]

The OCC ordered JPMC to take remedial action, which included in the appropriately-named section "Management and Accountability":

> The Bank shall ensure there are clear lines of authority and responsibility for BSA/AML *and OFAC compliance with respect to lines of business and corporate functions*, and that competent and independent compliance management is in place on a full-time basis.
>
> * * *
>
> The Bank shall ensure that senior management and line of business management are accountable for effectively implementing bank policies and procedures, and fulfilling *BSA/AML/OFAC obligations*. The Bank shall incorporate BSA/AML and *OFAC compliance* into the performance evaluation process for senior and line of business management. Additionally, written Bank policies and procedures shall clearly outline the *BSA/AML/OFAC responsibilities* of senior management and relevant business line employees, including, but not limited to, relationship managers, business banking, commercial banking, correspondent banking and private banking personnel, and legal and business development staff.

A-155 (*Id.* at Art. IV ¶¶ (1), (3)) (emphasis added) (footnote omitted). In addition,

[10] The 2013 OCC Consent Order followed an examination of JPMC and constituted a settlement of a cease and desist proceeding against the Company contemplated by OCC based on its findings of unsafe or unsound practices and violations or law or regulation. A-172.

the Company was required to provide an action plan for the completion of an evaluation of its BSA/AML and OFAC Programs, and the evaluation itself was obligated to "include assessments of the BSA/AML and OFAC Compliance Programs' organizational structure, enterprise-wide effectiveness, competency of management, accountability, staffing requirements, internal controls, customer due diligence processes, risk assessment processes, suspicious activity monitoring systems, audit/independent testing, and training." A-156 (*Id.* at Art. V ¶¶ (1)-(2)).

The 2013 OCC Consent Order also mandated that JPMC "develop and maintain an effective program to audit the Bank's BSA/AML and OFAC Compliance Programs ('Audit Program')." A-167 (*Id.* at Art. X ¶ (1)). The Audit Program was required to include:

> A formal process to track and report upon Bank management's remediation efforts to strengthen the Bank's BSA/AML/OFAC compliance program;
>
> Testing of the adequacy of internal controls designed to ensure compliance with BSA and OFAC, and their implementing regulations; [and]
>
> A risk-based approach that focuses transactional testing on higher-risk clients, products, geographies, and significant relationships.

Id. (*Id.* at Art. X ¶ (1)(a)-(c)). The "audit function" was also required to "be adequately staffed with respect to experience level, specialty expertise regarding BSA/AML *and OFAC*, and number of the individuals employed." A-168 (*Id.* at ¶

(3)) (emphasis added).

Finally, the 2013 OCC Consent Order compelled JPMC to "ensure that new products and services are subject to senior level compliance review and approval. These reviews must consider the quantity of BSA/AML *and OFAC risk* of the new product or service as well as the quality of risk management." A-169 (*Id.* at Art. XI. ¶ (1)).

3. *The Fed Consent Order*

The Consent Order executed with the Fed on January 14, 2013, also addressed compliance with OFAC requirements. It stated that:

> Within 60 days of this Order, JPMC shall submit an acceptable written plan to the Reserve Bank to improve the firmwide compliance risk management program with regard to BSA/AML Requirements and the regulations issued by the Office of Foreign Assets Control of the United States Department of the Treasury ("OFAC") (31 C.F.R. Chapter V). The plan shall, at a minimum, address, consider, and include:
>
> (a) The scope and frequency of compliance risk assessments;
>
> (b) enhanced written policies, procedures, and compliance risk management standards;
>
> (c) *the duties and responsibilities of compliance personnel for each business line, program, and legal entity regarding BSA/AML and OFAC compliance functions, including the reporting lines within JPMC, and between JPMC and its business lines and legal entities*;
>
> (d) a process for periodically reevaluating staffing needs in relation to the organization's compliance risk profile;

> (e) measures to ensure compliance and improve accountability within all business lines and legal entities and their respective compliance functions;
>
> (f) procedures for the periodic testing of the effectiveness of the compliance risk management program; and
>
> (g) consistency with the Board of Governors' guidance regarding Compliance Risk Management Programs and Oversight at Large Banking Organizations with Complex Compliance Profiles, dated October 16, 2008 (SR 08-8).

A-188-89 (Complaint Ex. C ¶ 3) (emphasis added).

The 2013 OCC and Fed Consent Orders covered: (1) economic sanctions compliance; and (2) global BSA/AML compliance by JPMC, which involved transactions that had nothing to do with Madoff. The present Action sought to recover damages to JPMC arising from the Consent Orders that were the result of Defendants' breaches of fiduciary duties. However, this claim, as was the claim for damage based on the OFAC Settlement Agreement, was barred by the trial court through its overly broad interpretation of the *res judicata* effect of the *Central Laborers'* decision.

4. *The 2014 OCC Consent Order for the Assessment of a Civil Money Penalty*

On January 7, 2014, the OCC and JPMC entered into a Consent Order for the Assessment of a Civil Money Penalty ("2014 OCC Consent Order"). A-243-62 (Complaint Ex. E). The 2014 OCC Consent Order noted that "[e]xaminations

conducted subsequent to the issuance of the January 2013 [Consent] Order have revealed additional deficiencies in the Bank's BSA/AML compliance program, which resulted in the citation of additional violations of law and regulation." A-244-45.

Among the "critical deficiencies in the elements of the Bank's BSA/AML compliance program" were:

> The Bank does not have *enterprise-wide policies and* procedures to ensure that *foreign branch suspicious activity involving customers of other bank branches* is effectively communicated to other affected branch locations and applicable AML operations staff. The Bank also does not have *enterprise-wide policies and procedures* to ensure that on a risk basis, *customer transactions at foreign branch locations* can be assessed, aggregated, and monitored.
>
> *The Bank's internal controls, including filtering processes and independent testing, with respect to Office of Foreign Asset Control ("OFAC") compliance are inadequate.*
>
> The Bank has not established adequate BSA/AML and due diligence programs for its foreign branches, offices, or affiliates.
>
> The Bank did not establish and implement an adequate BSA/AML program for correspondent banking and remote deposit capture ("RDC") and international cash letter ("ICL") products or adequate internal controls, including the Bank's due diligence programs, in the correspondent banking and RDC/ICL areas. *Inadequate controls resulted in certain special accommodation clients in the Bank that operated outside of the normal* AML monitoring and *OFAC screening controls.*
>
> The Bank has failed to correct previously reported problems in several areas, including Asia Private Banking, and with respect to one of its correspondent bank relationships.

> The Bank maintained a correspondent banking relationship with a Puerto-Rican-chartered affiliate of a Venezuelan bank. Although the Bank filed SARs relating to this correspondent account, the Bank did not investigate additional suspicious activity, totaling over $2 billion, pertaining to counterparties that flowed through the account at the Bank.
>
> From 2004 to 2010, the Bank failed to adequately monitor, investigate and file SARs on approximately $450 million of suspicious bulk cash transactions in an account at the Bank for another of its correspondents.
>
> From February 2013 to March 2013, the Bank failed to adequately monitor and file a supplemental SAR on ongoing activity relating to $471,680 in suspicious transactions in an account at the Bank for a third correspondent.

A-246-49 (*Id.* at Art. I ¶¶ (4)(d), (6)-(9), (12)-(14)) (emphasis added).[11]

Under the 2014 OCC Consent Order, OCC ordered and JPMC agreed to pay a civil penalty in the amount of $350 million. A-117, 249 (¶ 235 & Ex. E Art. II ¶ (1)). Again, the present Action sought to recover this amount as the civil penalty resulted from Defendants' breaches of their fiduciary duties. However, the trial court barred this claim through its overly broad wide interpretation of the *res judicata* effect of *Central Laborers'*.

C. The Deferred Prosecution Agreement and the *Central Laborers'* Decision

On January 6, 2014, the U.S. Attorney's Office for the Southern District of

[11] Of the OCC's fourteen findings, only one specifically concerned JPMC's AML/BSA deficiencies regarding Madoff. A-248 (Complaint Ex. E Art. I ¶ 11).

New York filed a two-count criminal Information against JPMC, styled *United States of America v. JP Morgan Chase Bank, N.A.* The first count described the Company's AML transgressions exclusively with regard to Madoff and BMIS and charged JPMC with failing to maintain an effective AML program in violation of the BSA and its implementing regulation. A-206-11 (DPA, Complaint Ex. D). The statutory allegation of the second count charged JPMC with "fail[ing] to file a Suspicious Activity Report in the United States with respect to transactions in bank accounts *maintained by Madoff Securities*." A-212 (*Id.*) (emphasis added). The Statement of Facts to which JPMC admitted as part of the DPA stated that the allegations in the DPA stemmed from a lack of AML/BSA compliance by JPMC's Investment Bank's Broker-Dealer Banking Group. *See Central Laborers',* 2014 U.S. Dist. LEXIS 100874, at *5 n.3; A-217 (*Id.*). Madoff's illegal conduct, and therefore JPMC's Madoff-related AML/BSA violations, ended no later than December 11, 2008, when Madoff was arrested. A-208, 216.

On February 19, 2014, without the benefit of books and records, Central Laborers' filed its complaint. *See Central Laborers',* 2014 U.S. Dist. LEXIS 100874, at *5; A-331 (*Central Laborers'* complaint). The *Central Laborers'* case was characterized as an action "seek[ing] damages suffered by JPMorgan as a result of its business relationship with Bernard L. Madoff Investment Securities LLC ('BMIS'), including JPMorgan's recent deferred prosecution agreement

('DPA') with the U.S. Attorney's Office for the Southern District of New York ('USAO'), in which JPMorgan agreed to pay the government $2.6 billion."[12] 2014 U.S. Dist. LEXIS 100874, at *2. The allegations in *Central Laborers'* were confined exclusively to the defendants' misconduct with respect to Madoff's and BMIS' activities, and the complaint was dismissed on the basis that plaintiff failed to establish demand futility. 2014 U.S. Dist. LEXIS 100874, at *17. The court did not discuss the merits of the allegations against the defendants.

D. The Present Action

On January 25, 2013 – over a year before the *Central Laborers'* action was filed and nearly a year prior to the execution of the DPA – Plaintiff served a demand for books and records on JPMC's Board, and engaged in numerous meet and confers with JPMC's counsel. A-31, 109 (¶¶ 16, 221). In response, the Company provided approximately 5,000 pages of books and records. A-31 (¶ 16).

On May 23, 2014, Plaintiff filed a shareholder derivative action against certain current and former directors and officers of the Company for breach of their fiduciary duty of oversight as a result of their knowing failure to stop or remedy

[12] This statement is factually incorrect. JPMC agreed to pay the United States $1.7 billion under the DPA. A-195. The court clarified its intent, and accurately summarized the plaintiff's complaint later in the opinion dismissing the action: "Plaintiffs filed a shareholder derivative complaint, seeking damages as a result of JPMorgan's payment of $2.6 billion in penalties and settlements to federal authorities through the DPA *and to civil plaintiffs concerning its conduct related to Madoff*." 2014 U.S. Dist. LEXIS 100874, at *5 (emphasis added).

repeated violations of U.S. economic sanctions and related AML/BSA law. A-22-262.

On September 8, 2014, Defendants moved to dismiss the Complaint, arguing that Plaintiff was precluded from alleging demand futility on the grounds of collateral estoppel and *res judicata*. A-288-97.[13] Defendants further argued that even if collateral estoppel and *res judicata* were not applicable, the Complaint failed to adequately allege demand futility. A-297-325. On November 3, 2014, Plaintiff filed its opposition, A-2258, and on December 17, Defendants filed their reply. A-2551. On March 23, 2015, the trial court heard oral argument. A-2594.

On July 29, 2015, the Court of Chancery issued its Memorandum Opinion dismissing the Complaint in its entirety on grounds of *res judicata*. Ex. A; 2015 Del. Ch. LEXIS 195. The court did not address the arguments concerning collateral estoppel or demand futility. *Id.* at *3, 20. Relying on an erroneous interpretation of the facts alleged in the Complaint, the court concluded that under New York law, the Complaint is barred by *res judicata*. *Id.* at *3, 22, 33-34. Specifically, the Court concluded that the subject matter of "this case is the same as that of, at least, the *Central Laborers* action." *Id.* at *22. This appeal followed.

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[13] JPMC filed its initial motion to dismiss on the basis of demand futility on June 19, 2014. A-263-64.

ARGUMENT

Question Presented

Was the trial court's dismissal of the present Action on the basis that *Central Laborers'* barred Plaintiff's claims under New York's *res judicata* principles reversible error? Ex. A; 2015 Del. Ch. LEXIS 195, at *22, 25-35.

Scope of Review

"This Court reviews *de novo* a Court of Chancery's decision to dismiss a derivative suit under Rule 23.1." *Stone v. Ritter*, 911 A.2d 362, 371 (Del. 2006); *White v. Panic*, 783 A.2d 543, 549 (Del. 2001). The Court "determine[s] whether the trial judge erred as a matter of law in formulating or applying legal precepts." *Dunlap v. State Farm Fire & Cas. Co.*, 878 A.2d 434, 438 (Del. 2005). In addressing a motion to dismiss, the Court will:

> (1) accept all well pleaded factual allegations as true, (2) accept even vague allegations as "well pleaded" if they give the opposing party notice of the claim, (3) draw all reasonable inferences in favor of the non-moving party, and (4) . . . not affirm a dismissal unless the plaintiff would not be entitled to recover under any reasonably conceivable set of circumstances.

Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Holdings LLC, 27 A.3d 531, 535 (Del. 2011).

Merits of Argument

The trial court's decision rests on an erroneous interpretation of New York's

res judicata law.[14] New York applies a "transactional analysis" to determine whether successive actions are barred by *res judicata*. In this case, the trial court found the dismissal of *Central Laborers'*, a shareholder derivative action brought by a different plaintiff against Defendants for damages suffered by JPMC as a result of its business relationship with Madoff and BMIS based on breach of their oversight duties regarding the Company's AML/BSA program, on demand futility grounds barred Plaintiff's derivative action against Defendants for breach of their oversight duties with respect to the Company's failure to comply with economic sanctions laws, including related BSA/AML violations, *that occurred both before and after Madoff was arrested, involved more entities within JPMC and different types of violations, and resulted in penalties imposed on the Company that were unrelated to its BSA/AML failures regarding Madoff.* The trial court's application of New York's *res judicata* principles thus was overbroad. The trial court's dismissal of the present Action should be reversed and the matter remanded for further proceedings.

[14] The parties agree that New York's principles of *res judicata* apply to the present case. *See, e.g.*, *Pyott v. La. Mun. Police Emps.' Ret. Sys.*, 74 A.3d 612 (Del. 2013).

I. The Trial Court Erred by Holding That Plaintiff's Derivative Claims against Defendants Were Barred by New York's *Res Judicata* Principles

The trial court erroneously conflated the claims made in the Complaint with those in *Central Laborers'*. The trial court did not properly apply New York's "transactional analysis" test and arrived at the erroneous conclusion that the Complaint "is barred because the claims it advances arise out of the same series of transactions that were at issue in the Central Laborers' Action." 2015 Del. Ch. LEXIS 195, at *26. As a result, the trial court's dismissal of Plaintiff's Complaint should be reversed.

"The doctrine of res judicata precludes a party from litigating 'a claim where a judgment on the merits exists from a prior action between the same parties involving the same subject matter.'" *Josey v. Goord*, 880 N.E.2d 18, 20 (N.Y. 2007) (quoting *Hunter*, 827 N.E.2d at 274). "The Rule applies not only to claims actually litigated but also to claims that could have been raised in the prior litigation." *Hunter*, 827 N.E.2d at 274. "The rationale underlying this principle is that a party who has been given a full and fair opportunity to litigate a claim should not be allowed to do so again." *Id. See also Chen v. Fischer*, 843 N.E.2d 723, 725 (N.Y. 2005) ("The primary purposes of res judicata are grounded in public policy concerns and are intended to ensure finality, prevent vexatious litigation and promote judicial economy.").

New York "has adopted the transactional analysis approach in deciding *res judicata* issues. Under this address, once a claim is brought to a final conclusion, all other claims arising out of the same transaction or series of transactions are barred, even if based upon different theories or if seeking a different remedy." *O'Brien v. City of Syracuse*, 429 N.E.2d 1158, 1159 (N.Y. 1981) (internal citations omitted). New York courts use a "pragmatic test" to decide *res judicata* questions, one that "sees a claim or cause of action as coterminous with the transaction regardless of the number of substantive theories or variant forms of relief available to the plaintiff." *Smith v. Russell Sage Coll.*, 429 N.E.2d 746, 749 (N.Y. 1981) (quotation omitted). They look to "whether the facts are related in time, space, origin, or motivation, whether they form a convenient trial unit, and whether their treatment as a unit conforms to the parties' expectations or business understanding or usage." *Chen*, 843 N.E.2d at 725 (quotation omitted).[15]

New York courts recognize that overzealous application of the *res judicata* doctrine may result in "unfairness." *Id.* "In properly seeking to deny a litigant two 'days in court', courts must be careful not to deprive him of one." *Reilly v. Reid*, 379 N.E.2d 172, 175 (N.Y. 1978). To this end, "[i]t is not always clear whether

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[15] The trial court conceded that "the factual allegations in the Central Laborers' complaint differ substantially from the allegations in the Complaint here, insofar as the Central Laborers' allegations focus almost entirely on JPMorgan's connection to the Madoff Ponzi scheme, while Plaintiff studiously avoids discussing that situation at any length." 2015 Del. Ch. LEXIS 195, at *34-35.

particular claims are part of the same transaction for res judicata purposes." *Chen*, 843 N.E.2d at 725.

In applying New York's "transactional analysis" test, the trial court improperly conjoined the damages resulting from the DPA, which only concerned AML/BSA violations associated with Madoff's criminal activities, and those from the OFAC Settlement Agreement, the 2013 OCC Consent Order, the Fed Consent Order, and the 2014 OCC Consent Order, the latter of which were based either exclusively on economic sanctions violations or primarily on interconnected economic sanctions and AML/BSA violations. The trial court erroneously concluded that dismissal of the derivative action concerning the Madoff-related Ponzi scheme AML/BSA violations barred the present derivative action regarding economic sanctions and AML/BSA-related violations related thereto under *res judicata*. In so doing, the trial court overzealously applied New York's *res judicata* principles and unfairly denied Plaintiff the opportunity to seek recourse against Defendants on the Company's behalf for their breaches of fiduciary duty associated with its economic sanctions and related AML/BSA compliance, which were not connected to the Madoff scandal.

The trial court found that: (1) the OFAC Settlement, the OCC and the Fed Consents, and the 2014 OCC Consent involved economic sanctions compliance as well as AML/BSA compliance; (2) the DPA, and its accompanying Information

and Statement of Facts, "*[u]nlike the 2013 and 2014 OCC Consents . . . focus primarily on JPMorgan's involvement in the Ponzi scheme orchestrated by Bernard L. Madoff*"; and (3) "[t]he DPA also linked the Madoff-related compliance failures to the Company's *general failure* to establish an adequate anti-money laundering program." 2015 Del. Ch. LEXIS 195, at *12-13 (emphasis added). It also concluded "that factual allegations pertaining to the Madoff Ponzi scheme and JPMorgan's failures *in that connection permeate the Central Laborers' complaint.*" *Id.* at *15-16 (emphasis added).

Nevertheless, the trial court was "convinced that [the] Complaint is barred because the claims it advances arise out of the same series of transactions that were at issue in the Central Laborers' Action." *Id.* at *26. This was error. The DPA and the resulting *Central Laborers'* derivative action had no connection to: economic sanctions violations; money laundering for rogue nations, terrorists, and drug cartels; inadequate procedures and protections for dealing with foreign correspondent banks; or AML/BSA violations permeating JPMC's business segments as well as its overseas branches and subsidiaries, not just its Investment Bank's Broker-Dealer Banking Group.

The OFAC Settlement Agreement shared little, if anything, in common – facts, issues, or parties – with the DPA. The OFAC Settlement Agreement was *exclusively* about the Company's alleged economic sanctions violations involving,

to name just a few, the "Government of Cuba," the "Al-Aqsa Foundation," the "Government of Iran," and the "Government of Sudan." A-142-43 (OFAC Settlement Agreement at ¶¶ 3, 5-6, 8). The DPA concerned Madoff-related BSA/AML violations. *See* A-206-13 (Information). The $88.3 million payment made by JPMC under the OFAC Settlement Agreement was classified as a "civil penalty matter." A-144 (OFAC Settlement Agreement at ¶ 11(c)). The DPA resolved a criminal proceeding, and the $1.7 billion payment was deemed a forfeiture to be used to compensate the victims of Madoff's fraud. A-195, 234 (DPA ¶ 3 & Ex. D).

The OFAC Settlement Agreement and the DPA were not "the same transaction or series of transactions" under any reasonable analysis. *O'Brien*, 429 N.E.2d at 1159. As such, they do not form a "convenient trial unit." *Chen*, 843 N.E.2d at 725. If the trial court's decision is not reversed, Plaintiff will be denied its day in court on Defendants' breaches of fiduciary duty with respect to the OFAC Settlement Agreement after utilizing the "tools at hand" because of a fast-filed derivative complaint that solely concerned the DPA and the associated Madoff-related AML/BSA violations. *See Reilly*, 379 N.E.2d at 175.

The same is true for the 2013 OCC and Fed Consent Orders and the 2014 OCC Consent Order. The scope of each ranged far beyond the DPA, covering economic sanctions and associated AML/BSA violations, *many of which occurred*

years after Madoff was arrested in 2008.[16] To put it another way, the DPA *at best* covered a small bit of the far broader territory addressed in the 2013 OCC and Fed Consent Orders and the 2014 OCC Consent Order. The trial court interpreted the scope of the various agreements backwards; the DPA, and the violations it addressed, were small parts of the 2013 OCC and Fed Consent Orders and the 2014 OCC Consent Order, not the other way around. It appears the massive forfeiture gave the DPA a preclusive effect it did not deserve.

The trial court determined there were two reasons why the DPA could not "be separated from the other settlements and consent orders and treated as a distinct 'factual grouping,' such that the claims relating to the other settlements and consent orders might avoid preclusion." 2015 Del. Ch. LEXIS 195, at *28. The first reason was that "the DPA itself indicates that, rather than relating solely to the Madoff Ponzi scheme, that settlement was part and parcel of JPMorgan's *overall resolution of continuing BSA/AML and OFAC compliance violations* that had given rise to the previous settlements and consent orders." *Id.* (emphasis added).

[16] The Company's illegal conduct with respect to Madoff and BMIS ended in late 2008, even though the DPA was not signed until early 2014. In contrast, the two OCC Consent Orders and the Fed Consent Order were not limited to the Company's compliance failures prior to 2009. Indeed, the 2014 OCC Consent Order resulted from, among other things, the failure "to correct previously identified systemic weaknesses in the adequacy of customer due diligence and the effectiveness of monitoring in light of the customers' cash activity and business type," a new violation that occurred years after Madoff was put out of business. A-149-50 (2014 OCC Consent Order at Art. I ¶ (3)).

The second reason was that "the DPA explicitly references and re-affirms JPMorgan's obligations under the 2013 OCC Consent and the Fed Consent." *Id.* at *29.

Neither reason can withstand scrutiny. The DPA and its exhibits did not discuss or even reference the Company's compliance failures regarding the various economic sanctions laws and regulations or BSA/AML issues associated therewith.[17] The DPA *only* concerned AML/BSA violations by JPMC in connection with Madoff's Ponzi scheme. Critically, the trial court inaccurately summarized Plaintiff's Complaint as alleging that "Defendants knew the Company's efforts to remediate its BSA/AML deficiencies were unsuccessful, and

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[17] The closest the DPA comes to discussing anything but Madoff and JPMC's associated BSA/AML violations is in Paragraph 19 of the DPA, which stated:

> JPMorgan shall continue its ongoing effort to implement and maintain an effective *BSA/AML compliance program* in accordance with the requirements of the BSA and the directives and orders of any United States regulator of JPMorgan or its affiliates, including without limitation the OCC and Federal Reserve Board, as set forth in their respective Consent Cease and Desist Orders, dated January 14, 2013 ("Consent Orders"). The Office acknowledges that, pursuant to the Consent Orders, JPMorgan *has implemented and is continuing to implement significant remedial changes to its BSA/AML compliance program*, prior to the entry of this Agreement. It is understood that a violation of the BSA or the Consent Orders arising from conduct occurring prior to the date of execution of this Agreement, including with respect to any SAR-filing obligation, will not constitute a breach of JPMorgan's obligations pursuant to this Agreement.

A-199-200 (emphasis added). This language has nothing to do with economic sanctions compliance or the AML/BSA requirements associated therewith; it is limited to general AML/BSA compliance.

yet allowed the Company's compliance systems to deteriorate further, ultimately resulting in over $2 billion in regulatory fines and penalties." *Id.* at *18. Based on the trial court's inaccurate characterization of the facts alleged in the Complaint, it found that "the subject matter of this case is the same as that of . . . the Central Laborers' Action." *Id.* at *22.

The trial court also misread Plaintiff's Brief in Opposition to the Opening Brief in Support of Motion to Dismiss the Verified Shareholder Derivative Complaint for Breach of Fiduciary Duty, A-2269-73 ("Opposition Brief" at 1-5). 2015 Del. Ch. LEXIS 195, at *18-19. For example, the Opposition Brief stressed that the Complaint "allege[d] with particularity that, [REDACTED] A-2269-70 (Opposition Brief at 1-2) (emphasis added). It also said that Defendants [REDACTED] and that "*[t]hese allegations have not been alleged in any prior action against the JP Morgan board.*" A-2272 (*Id.* at 4) (emphasis added).

As a result, the trial court's conclusion that the DPA was "part and parcel of JPMorgan's overall resolution of continuing BSA/AML and OFAC compliance violations that had given rise to the previous settlements and consent orders" is not supported by the record.

In addition, the day after the DPA was signed, JPMC entered into the 2014 OCC Consent Order, *which imposed an additional civil penalty of $350 million for AML/BSA violations based primary on the Company's economic sanctions compliance failures*. The trial court conflated this Order with the DPA by asserting "the 2014 OCC Consent references the 2013 OCC Consent and the DPA. It also includes a finding that JPMorgan's 'internal controls, including filtering processes and independent testing, with respect to . . . OFAC . . . compliance are inadequate,' and that those inadequacies resulted in the Company 'operat[ing] outside of the normal AML monitoring and OFAC screening controls.'" 2015 Del. Ch. LEXIS 195, at *29. This meant, according to the trial court, that:

> the relevant settlement and consent order documents themselves indicate that each individual transaction was part of one series of transactions relating to the Company's resolution of various alleged BSA/AML *and OFAC violations* during the Relevant Period. In other words, it is not possible to read the OFAC Settlement, the 2013 OCC Consent, the Fed Consent, the DPA, and the 2014 OCC Consent and conclude that they do not form a "single factual grouping" and make '"a convenient trial unit.'"

Id. at *29-30 (emphasis added).

The economic sanctions and related AML/BSA fiduciary breaches associated with the 2014 OCC Consent Order were separate and distinct from the DPA. Moreover, the fact that a later agreement may have mentioned a previous one does not make both "part of the same transaction for res judicata purposes." *Chen*, 843 N.E.2d at 725. The findings in the 2014 OCC Consent Order such as:

> The Bank does not have enterprise-wide policies and procedures to ensure that foreign branch suspicious activity involving customers of other bank branches is effectively communicated to other affected branch locations and applicable AML operations staff. The Bank also does not have enterprise-wide policies and procedures to ensure that on a risk basis, customer transactions at foreign branch locations can be assessed, aggregated, and monitored;
>
> The Bank's internal controls, including filtering processes and independent testing, with respect to . . . OFAC . . . compliance are inadequate; and
>
> The Bank did not establish and implement an adequate BSA/AML program for correspondent banking and remote deposit capture ("RDC") and international cash letter ("ICL") products or adequate internal controls, including the Bank's due diligence programs, in the correspondent banking and RDC/ICL areas. Inadequate controls resulted in certain special accommodation clients in the Bank that operated outside of the normal AML monitoring and OFAC screening controls,

are unrelated to the Company's transgressions regarding AML/BSA compliance concerning Madoff's Ponzi scheme, regardless of whether the DPA was mentioned in the Consent Order (which it was in one paragraph of the preamble, and in one paragraph of the findings). In effect, the dismissal of *Central Laborers'*, which

only implicated the DPA and Defendants' breaches of duty with respect thereto, on demand futility grounds served as an impermissible release of Defendants' derivative liability regarding economic sanctions oversight and AML/BSA oversight worldwide.

In sum, the trial court's determination that *Central Laborers'* barred Plaintiff's economic sanctions and associated AML/BSA derivative claims misinterpreted New York's *res judicata* principles and unfairly denied Plaintiff its day in court regarding the breaches of fiduciary duties by Defendants that resulted in significant damage to the Company. For the reasons discussed above, the trial court's dismissal of the present Action should be reversed and the matter remanded for further proceedings.

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