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Case Number 606,2016

IN THE SUPREME COURT OF THE STATE OF DELAWARE

MURRAY ZUCKER,	)	
	)	
Plaintiff-Below,	)	
Appellant	)	C.A. No. 606, 2016
	)	
GERALD HASSELL, *et.al.*	)	
	)	
Defendants-Below,	)	
Appellees,	)	
	)	
THE BANK OF NEW YORK MELLON CORPORATION	)	
	)	
Nominal Defendant-Below	)	
Appellee,	)	

PUBLIC VERSION OF THE APPELLANT'S CORRECTED OPENING BRIEF

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Dated: March 8, 2017

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I. NATURE OF PROCEEDINGS

Prior to initiating this action, Plaintiff-Appellant Murray Zucker ("Plaintiff"), a long time common shareholder of The Bank of New York Mellon Corporation ("BNYM" or the "Company"), demanded that the BNYM Board of Directors (the "Board"),[1] among other things, "conduct an independent investigation" with respect to "mismanagement and breaches of fiduciary duty" in connection with BNYM's foreign exchange practices (the "Litigation Demand"). Plaintiff filed his shareholder derivative complaint (the "Complaint")[2] after the Board wrongfully refused the Litigation Demand (the "Demand Refusal").

The Complaint alleges that certain current and former members of the Board and its officers, or managing directors of its wholly owned subsidiary,[3] breached their fiduciary or other legal duties to the Company by improperly allowing or causing certain conduct in the running of BNYM's profitable foreign exchange ("FX" or "forex") business. Specifically, Plaintiff alleges that Defendants made improper representations to BNYM custodial clients ("clients") regarding how

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[1] Defendants Gerald L. Hassell, Robert P. Kelly, Ruth E. Bruch, Nicholas M. Donofrio, Edmund F. Kelly, Richard J. Kogan, Michael J. Kowalski, John A. Luke, Jr., Mark A. Nordenberg, Catherine A. Rein, William C. Richardson, Samuel C. Scott III, John P. Surma, Steven G. Elliott, Robert Mehrabian and Wesley W. von Schack (collectively the "Director Defendants").

[2] The Complaint, filed on October 20, 2015, sought damages and enhanced corporate governance.

[3] Richard Mahoney, Jorge Rodriguez and David Nichols (together with the Director Defendants, the "Defendants"). Complaint ¶¶ 15-24. Hereinafter, all "¶ _" mean and refer to the Complaint, A-8 – A-117.

BNYM's FX trades, known as "non-negotiated," "indirect" or "standing instruction" ("SI") transactions would be priced (the "Alleged Wrongdoing"). As a result of the Alleged Wrongdoing, as acknowledged by BNYM and defendant Nichols, Defendants caused BNYM to pay out hundreds of millions of dollars to settle private civil, administrative and governmental actions.

BNYM described its Standing Instruction Service (the service used for the SI trades) as free and "cost-effective." BNYM said it followed "best execution" standards, requiring it to extend every effort to obtain the best price for its clients. In actuality, BNYM "would note the low and high exchange rate of the day for the two currencies involved in the FX trade." At the end of the trading day, BNYM "ignored the price [it] paid for the FX [conversion]" and/or the market rate at the time the trade was executed and charged its clients for the "FX transaction as if the trade occurred at either the high or low of the day (depending on the nature of the transaction, buy or sell), in order to charge the least favorable rate that occurred that trading day," keeping the difference for itself as profit.

Defendant Nichols, and BNYM's wholly owned subsidiary The Bank of New York Mellon, acknowledged wrongdoing by, among other things, making misrepresentations to customers about the pricing of SI FX trades. Between paying civil fines in the U.S. Action, defined below, for admitted wrongdoing and other settlements of various actions, BNYM was forced to pay almost $1 billion.

After obtaining certain documentation following the 220 Trial (defined

below), the underlying action was filed and then dismissed on November 30, 2016, for failing to adequately plead demand was improperly refused.

II. SUMMARY OF ARGUMENT

The Complaint adequately pled facts which, if proven, establish that the Demand Refusal was wrongful due to the Board's gross negligence.[4] In other words, the Complaint raises a reasonable doubt that the Director Defendants complied with their fiduciary duties in refusing the Litigation Demand.

Plaintiff asserts that the Chancery Court erred in: (i) its application of the standard of pleading facts that raise a reasonable doubt that the Director Defendants complied with their duties in consideration of the Litigation Demand; and (ii) allowing Defendants to use the attorney client privilege and/or the attorney work product immunity as both a shield and a sword to unfairly take advantage of redactions it was permitted to make to critical documents.

[4] "Gross negligence has been defined as 'conduct that constitutes reckless indifference or actions that are without the bounds of reason.'" Opinion at 20, *quoting Ironworkers Dist. Council v. Andreotti*, 2015 Del. Ch. LEXIS 135, at * 87, n.235 (Del. Ch. May 8, 2015).

III. STATEMENT OF FACTS

A. The Foreign Exchange Scheme

BNYM's practice of marking up foreign exchange purchases and marking down foreign exchange currency sales to its clients at, near, or outside of daily foreign currency trading prices has led to negative publicity and private and government lawsuits. As a result BNYM paid hundreds of millions of dollars in government fines and settlement of civil litigation. ¶¶ 8-10, 171

The underlying conduct involved SI FX trades. During the relevant time period BNYM's website stated that SI FX trades "provide a simple, flexible, and complete service solution that automates the capture of all types of custody-related foreign exchange, including securities trade settlement, income conversions, corporate actions, tax reclaims, interest postings, and residual balances." ¶¶ 50, 135, 185, 200. BNYM touted its ability to provide "FX execution according to best execution standards" while charging clients for fees beyond those permitted by and negotiated for in master trust agreements. ¶¶ 51, 52, 121, 123, 158.

BNYM's Global Markets Website described SI FX trades as being "operationally simple" and "free of charge." ¶¶ 52, 135, 176, 200. BNYM improperly claimed to its clients that SI FX transactions were "according to best execution standards" requiring BNYM to obtain the best price for clients. "Best execution" commonly means that the client receives the best available market price at the time that the currency trade is executed. BNYM made these fraudulent

statements on its website, in response to RFPs (Requests for Pricing of FX trades) and/or in responses to other inquiries from clients regarding FX services. ¶¶ 49-50.

To conceal its actions and reap secret profits at its clients' expense which in turn artificially inflated Defendants' compensation and opened BNYM up to private and governmental claims, including civil penalties, BNYM's account statements generally reported SI FX conversion rates that fell within (or close to) the high and low range for each day's FX rates but failed to provide time stamped execution prices. This prevented clients from discovering that the FX rates charged were manipulated and inconsistent with their agreements with BNYM. ¶ 54

BNYM engaged in the wrongful conduct for one reason – profit. As defendant Rodriguez wrote in a February 1, 2008 email to defendant Mahoney, "[a]s we all know, Standing Instruction [Service] is the most profitable form of business." Similarly, a December 2008 internal e-mail to BNYM's Global Market Management Committee noted how, despite the financial crisis, BNYM's SI FX trading had made "bundles of cash." ¶76.

Unbeknownst to its clients, BNYM's foreign exchange traders rarely, if ever, charged the foreign exchange rate actually paid by BNYM at the time of a trade to clients. Instead, SI FX trade orders were generally filled once a day out of BNYM's "inventory" of currencies, with BNYM assigning the rates that it ultimately reported to, and charged or credited its SI FX trade clients. ¶¶ 80-81. These assigned rates corresponded to the extreme high or extreme low prices of the

day without regard to the price BNYM actually paid (or received) for foreign currency, the price at the moment of the internal currency transfer, or the foreign exchange rate of the time of the standing instruction trade request. ¶ 81.

Moreover, BNYM falsely stated to clients that "we price foreign exchange at levels generally reflecting the interbank market at the time the trade is executed by the foreign exchange desk." ¶ 130. However, BNYM's SI FX pricing had nothing to do with the "time" of any trade or when any trade was actually "executed." ¶¶ 131-32. Indeed, internal BNYM communications demonstrate that high-ranking members of the Company management were aware of the deceptive SI FX trading scheme, openly supported it and its importance to the profitability of the Bank, and understood its importance to their compensation. ¶¶ 139-42.

B. The U.S. Action and Settlement

An action brought by the United States Department of Justice (the "U.S. Action")[5] charged defendants BNYM and Nichols of violating the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, 12 U.S. Code § 1833a ("FIRREA"), by engaging in "a scheme to defraud custodial clients by making or causing to be made false and/or misleading representations concerning BNYM's standing instruction foreign exchange ('FX') product . . . and concealing how BNYM priced such FX transactions[.]" ¶ 174.

As part of the Stipulation and Order of Settlement and Dismissal in the U.S.

[5] An action brought by the New York Attorney General also resulted in a settlement.

Action, BNYM admitted the actions it took in violating FIRREA. ¶ 175. It admitted that: its practice was to aggregate those SI FX transactions for all SI clients and group them by currency pair; near the end of the trading day or session, the Bank priced those SI FX trade requests it had received that day; to determine the price for each SI FX transaction for most currencies, the Bank examined the range of reported interbank rates from the day and assigned the rate on SI trades as follows: if the client was (a) purchasing foreign currency, the client received a price at or close to the highest reported interbank rate for that day or session (at or near the least favorable interbank price for the client), and (b) selling foreign currency, the client received a price at or close to the lowest reported interbank rate of the day or session (also at or near the least favorable interbank price for the client); BNYM represented to clients that the service provided "benefits" to clients, including "FX execution according to best execution standards." ¶ 176

BNYM also accepted responsibility for and admitted that "[c]ontrary to the representations it made to its clients, including that BNYM offered 'best rates,' it gave SI clients prices that were at or near the worst interbank rates reported during the trading day or session"; it "generally did not disclose its SI FX pricing methodology discussed above to its custodial clients or their investment managers;" it "was aware that many clients did not fully understand the Bank's pricing methodology for SI transactions;" and the "Bank was aware that many market participants equated 'best execution' with best price or considered best

price to be one of the most important factors in determining best execution." *Id.*

Defendant Nichols made substantially similar admissions; accepted responsibility for the wrongful conduct; and admitted that he participated in the drafting and dissemination of the BNYM's description of "best execution" and the SI product. He also admitted that he had oversight of the Global Markets website and approved the content, which included the statement that BNYM's clients "benefit from . . . FX execution according to best execution standards." ¶ 177.

Nichols also admitted that he "understood how BNYM priced SI transactions". He understood that after looking at the high and low of the currency for the day the customer's transaction would be close to the least favorable rate possible. *Id.* Nichols also admitted that he knew that: BNYM "generally did not disclose its SI FX pricing methodology . . . to its custodial clients or their investment managers;" "[m]any clients did not fully understand the Bank's pricing methodology for SI transactions;" and "[m]any market participants equated 'best execution' with best price or considered best price to be one of the most important factors in determining best execution." ¶ 177.

IV. PROCECURAL HISTORY

A. The Litigation Demand and Demand Refusal

Plaintiff sent the Litigation Demand on March 9, 2011. ¶¶ 39, 179. Plaintiff demanded, among other things, that the Board "conduct an independent investigation" with respect to "mismanagement and breaches of fiduciary duty" in

connection with foreign exchange practices." ¶¶ 39, 179.

On October 6, 2011, BNYM issued a full page newspaper advertisement refuting claims that it had not "been truthful about the pricing of foreign exchange (FX) services we provide to our institutional clients" ("BNYM's Ad"). Plaintiff understood BNYM's Ad to be an implied rejection of the Litigation Demand. *See, e.g.* ¶¶ 181-82.

A formal rejection to the demand was sent to Plaintiff by Cravath, Swain & Moore LLP ("Cravath"), counsel for a special committee (the "Special Committee") of the Board, on December 14, 2011 (the "Demand Refusal"). The Demand Refusal simply concluded, in large part, that based on the Special Committee's investigation there was no sound legal basis to bring any claim, and, even if there were, an action was not in BNYM's best interests. ¶ 184.

In terms of the scope of review, the Demand Refusal refers to the selection of 10,000 documents for review by the Special Committee's counsel (the "Cravath Documents"). The only information on the criteria used to select the Cravath Documents was that they related to "the Company's foreign exchange trading practices." ¶ 185. The Demand Refusal also notes that, in consideration of the Alleged Wrongdoing, Cravath conducted 13 interviews and had several meetings with and made presentations to the Board and its Special Committee. ¶ 186.

B. The New York Action

Plaintiff initially filed a derivative action in the Supreme Court of the State of New York (the "New York Action") on October 25, 2011. ¶ 41. The court dismissed the New York Action without prejudice on October 1, 2013. The New York Supreme Court found that "in keeping with the fact that the Delaware courts have allowed actions such as this to be dismissed without prejudice and the possibility of repleading either based on a better pled complaint and/or a better pled complaint after more information is obtained under 8 Del. C. § 220 ("Section 220"). A-196 at 5-16; *see also* ¶ 44.

C. The 220 Demand and Trial

On October 7, 2013, Plaintiff made a Section 220 demand for BNYM books and records concerning Cravath's underlying investigation and recommendation to the Special Committee (the "220 Demand"). ¶ 45. On November 8, 2013, BNYM produced certain documents which were the documents produced in response to a Section 220 demand by another shareholder, Carole Kops (the "Kops Production"). ¶ 46. The Kops Production included certain minutes and supporting materials from Board and Special Committee meetings; FX practices documents provided to governmental or regulatory entities; letters that formally refused other shareholder litigation demand relating to the Company's FX practices; and the Cravath Documents. BNYM's production did not respond to many of the categories of documents set forth in the 220 Demand. *Id.*

After attempting to resolve the 220 Demand informally but receiving only a handful of additional pages, a trial was held on July 16, 2015, before the Court of Chancery (the "220 Trial"). As a result, BNYM produced certain additional documents in August 2015. ¶¶ 47-48. In addition, as a result of the 220 Trial, Plaintiff was informed which of the Cravath Documents were reviewed by the Special Committee itself – fewer than 30 of the 10,000 Cravath Documents (the "Committee Document(s)"). ¶¶ 189-90.The Committee Documents provide no basis for a finding that the Special Committee's investigation was reasonable and/or conducted in good faith. *Id.*

Among other things, the Committee Documents include [redacted] ¶¶ 192-93. These documents fail to shed any light on the Alleged Wrongdoing and/or why it was not in the interest of BNYM or its shareholders to institute litigation. *Id.*

One Committee Document, asks [redacted] ¶ 194. In light of the admission that clients were not given best execution, all this document does is confirm Defendants' misrepresentations, which the Special Committee, if not for its gross negligence, should have recognized.

Another document [redacted]

[redacted]

[redacted]

¶ 195. Other Committee Documents similarly shed no light on the issues raised by the Litigation Demand. *See, e.g.*, ¶¶ 196-98.

The Committee Documents demonstrate that Nichols recognized that transparency was called for only when absolutely necessary for a particular deal. For example, in an email chain, [redacted]

[redacted]

[redacted]

[redacted]

6 [redacted]

[redacted]

Another Committee Document, [redacted]

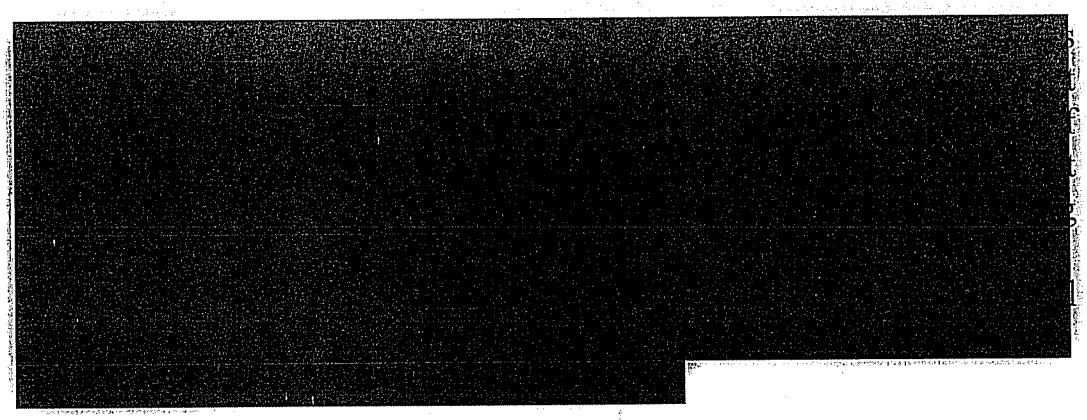
[redacted]

Another document reviewed with the Special Committee confirms the Alleged Wrongdoing and Defendants' active misrepresentations to clients. ¶ 202. Although the BNYM and Nichols now admit that SI FX clients were charged near the high or low of the day, whichever was advantageous to BNYM, the document reflects that customers were misled, stating:

[redacted]

Perhaps the most damning document that the Special Committee reviewed was a [redacted]

[redacted]



¶¶ 77, 204. All that seemingly mattered to Defendants was profit – not clients or the ultimate consequences of the conduct if caught. *See also* ¶

D. Memorandum Opinion

On November 30, 2016, the Court entered its Memorandum Opinion and Order (the "Opinion") granting Defendants' Motion to Dismiss. Opinion at 34-35. The Opinion holds that Plaintiff must "allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort." *Id.* at 17-18.

In this case, that requirement can be satisfied by making "a demand on the corporation's board," but if the board refuses that demand "then the plaintiff must demonstrate that the board wrongfully refused the demand." *Id.* at 18. The Chancery Court explained that "the decision of an independent committee to refuse a demand should only be set aside if particularized facts are pled supporting an inference that the committee, despite being comprised solely of independent

directors, breached its duty of loyalty, or breached its duty of care, in the sense of having committed gross negligence." *Id.* at 19, *quoting Espinoza on behalf of JPMorgan Chase & Co. v. Dimon*, 124 A.3d 33, 36 (Del. 2015).

The Chancery Court found "no reason to doubt that the Directors complied with their duty of care, based on the facts pled." Opinion at 21. As part of its finding, the Chancery Court considered the appointment of Cravath to represent the Special Committee; Cravath's presentation to the Special Committee regarding the results of its fact finding; and the Committee's review of twenty eight documents. *Id.* at 28-29. The fact that there were "a few troubling documents is insufficient [ ] to infer bad faith or gross negligence on the part of the Special Committee in reaching the decision not to proceed with legal action." *Id.* at 29.

Among other things, the Chancery Court stated that it would not infer the heavily redacted materials produced in response to the 220 Trial ruling against Defendants because Plaintiff should have previously addressed that issue with the court. Opinion at 30-31; *see also* A-193-229. It also held that the Special Committee was not required to reconsider its evaluation of the Litigation Demand in view of the settlement entered into in the U.S. Action. Opinion at 32-33.

V. ARGUMENT

A. Question Presented

Whether the Chancery Court erred and abused its discretion in finding that the Complaint did not adequately allege that the Board improperly refused Plaintiff's Litigation Demand. Question Preserved at A-236 – A-254

B. Scope of Review

"A decision on a motion under Chancery Rule 23.1, whether based on demand-excused or demand-refused, involves essentially a discretionary ruling on a predominantly factual issue. Accordingly, a ruling by the Court of Chancery that a plaintiff in a derivative suit has not pleaded a claim of wrongful refusal of demand will be reversed only on a showing of abuse of discretion, assuming no legal error led to an erroneous holding." *Scattered Corp. v. Chicago Stock Exch. Inc.*, 701 A.2d 70, 72-73 (1997). Thus, to the extent the error was a legal one, the review is *de novo*. To the extent it is factual, it is an abuse of discretion review.

C. Merits

1. The Standard for Satisfactorily Alleging that a Demand Was Wrongfully Refused

As the Chancery Court correctly stated, "a board's decision to refuse a plaintiff's demand is afforded the protection of the business judgment rule unless the plaintiff alleges particularized facts that raise a reasonable doubt as to whether the board's decision to refuse the demand was the product of valid business

judgment." In assessing whether the Board's decision to refuse demand was the product of a valid business judgment "the only issues to be examined are the good faith and reasonableness of its investigation." Opinion at 19, *citing Levine v. Smith*, 591 A.2d 194, 212 (Del. 1991).

In *Grimes v. Donald*, 673 A.2d 1207 (Del. 1996), this Court raised a question which had previously been raised by other courts as to why the term "reasonable doubt," a term more associated with criminal cases, was being used in derivative litigation. The Supreme Court explained:

> [T]he term is apt and achieves the proper balance. Reasonable doubt can be said to mean that there is a reason to doubt. This concept is sufficiently flexible and workable to provide the stockholder with "the keys to the courthouse" in an appropriate case where the claim is not based on mere suspicions or stated solely in conclusory terms.

Grimes, 673 A. 2d at 1219.

Thus, according to this Court, it is more than theoretically possible to meet the standard because of the element of flexibility in evaluating whether the Demand Refusal was the product of a valid business judgment. The main considerations are that the shareholders not seek to bypass the consideration of a board of directors by conclusory allegations or pleading what amounts to mere suspicion. It is a high standard, but one because of its flexibility mandated by this Court, contemplates a realistic possibility of adequately pleading wrongful refusal.

It is therefore surprising that the number of Delaware cases in which

demand refused was found to be adequately pled can be counted on one hand – with plenty of fingers still available. That the Chancery Court has upheld so few demand refused cases suggests, with due respect, that perhaps the Chancery Court has been, in the past, too inflexible in evaluating these types of cases, contrary to the holdings of this Court.[7]

In addition, the Court must draw all inferences in plaintiffs' favor if they are "reasonable inferences." *Andreotti*, 2015 Del. Ch. LEXIS 135, at *84 (Del. Ch. May 8, 2015); *Brehm v. Eisner*, 746 A. 2d at 255 ("Plaintiffs are entitled to all reasonable factual inferences that logically flow from the particularized facts alleged, but conclusory allegations are not considered as expressly pleaded facts or factual inferences.").

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[7] At oral argument on the Motion to Dismiss, counsel for Defendants indicated he had found only one Delaware case where demand was improperly refused – *Brehm v. Eisner*, 746 A. 2d 244 (Del. 1998). Even that, however, was not the case. *Brehm* was actually a demand futility case. Even the case cited by the Chancery Court, *Belendiuk v. Carrión*, 2014 Del. Ch. LEXIS 126, at *23, n.51 (Del. Ch. July 22, 2014), as a decision citing two cases wherein the court found that demand was improperly refused, needs context. Opinion at 29, n.117. One of those cases, *Seaford Funding Ltd. Ptnr. v. M & M Assocs. II, L.P.*, 672 A.2d 66 (Del. Ch. 1995), involved a limited partnership where a demand was made on the one general partner. The court found, because it was a limited partnership, the usual rule about conceding independence of director did not apply if a demand is made. The other case, *Thorpe v. CERBCO*, 611 A.2d 5 (Del. Ch. 1991), involved quite unusual circumstances in that a special committee was appointed to investigate a demand, but did not have the authority to make a final determination. After the committee performed an investigation, prepared a report and submitted it to the board, the company did not disclose the demand to its shareholders and the board never acted on the report. Under those circumstances, the court ruled that the demand was improperly refused. The court never addressed the question of whether there were sufficient allegations as to whether the board acted with gross negligence or in bad faith. Thus, the cases referenced by the Chancery Court, being *sui generis*, do not help illustrate the possibility of alleging that a board acted with gross negligence. These cases are outliers.

2. The Complaint Adequately Pleads That the Board Wrongfully Refused the Litigation Demand

The Chancery Court found "the Special Committee based its recommendation on the results of the investigation by Cravath, supplemented, at Cravath's recommendation, by its review of twenty-eight documents (and, surely by the Special Committee's own knowledge of BNYM's business). . . . nothing in the facts pled indicates that it was unreasonable (let alone grossly negligence) for the Board to rely on that investigation or reach the conclusion it did or reach the conclusion it did in reliance on the investigation." Opinion at 5-6. The Chancery Court erred.

a. It was Error to Consider the Facts in Isolation

The Chancery Court focused on the fact that: the Board "empowered a committee of independent directors (the 'Special Committee') to evaluate the claim and recommend action;" the "Special Committee hired competent corporate counsel . . . to assist it;" "Cravath performed an investigation on behalf of the Special Committee and did "what appears to be a thorough canvas of witnesses and facts",[8] and Cravath "advised the Special Committee through an oral presentation

[8] The Chancery Court suggested that the Special Committee appears to have performed a "thorough canvas of witnesses and facts" other than the facts brought to its attention by Plaintiff. Opinion at 27-28. And those included at least one document that the Chancery Court found "troubling." Opinion at 28. And although the Chancery Court was presented by Plaintiff with references to many of the documents reviewed with the Special Committee, it did not indicate that even one of them were consistent with a lack of wrongdoing. While the Chancery Court indicates that the Special Committee performed a thorough "canvas" of witnesses, it provides no basis for believing that the canvassing of witnesses was thorough. It just cites the number of

and by providing documents for the Committee's review of the results of its fact-finding." There was also a determination by the Special Committee "that there was no sound legal basis for any claim and that, in any event, litigation was not in the corporate interest." Opinion at 4. Based on those actions, the Chancery Court found that "nothing on the face of this procedure indicates gross negligence." *Id.*

However, if following procedure alone, while ignoring information discerned from an investigation, provides protection from a finding of gross negligence, every board could somnambulate during these basic procedures so long as it can cite to review of a significant number of documents and interviews. That would make it virtually impossible to demonstrate gross negligence.

Moreover, the Chancery Court's weight to the "Special Committee's own knowledge of BNYM's business," as a factor supporting the reasonableness of relying on Cravath, supports that the Demand Refusal was wrongful. A reading of the Demand Refusal indicates that the Special Committee and Board blindly relied on Cravath. That the Special Committee understood BNYM's business is evidence that the Board members also knew of the Company's SI FX pricing and disclosure process as it was a major part of BNYM's business – further evidencing that the Litigation Demand was wrongfully refused. To understand the fraudulent nature of the SI FX pricing system the Board should not have needed a confession by

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witnesses interviewed, a number which Plaintiff never challenged. The only way that the Chancery Court could have been in a position to know if the canvas of witnesses was thorough, was if it had permitted the documents discussed, *infra*, to be produced without redactions.

BNYM or Nichols that they understood that clients did not understand it.

The Chancery Court also found that Plaintiff made a *res ipsa loquitar* argument that because "years after the demand was refused, wrongdoing and liability were admitted by BNYM in connection with a settlement" that "the investigation by the Board and Special Committee – which failed to turn up this wrongdoing – must have been grossly negligent." Opinion at 4-5. Plaintiff does not rely on those facts alone. The Chancery Court failed to look at the facts as a whole and consider, in context, the documents reviewed with the Special Committee. Although it is important to review enough documents, interview enough people and have enough meetings, gross negligence can be inferred from the information gathered from those sources.

With a detailed factual record such as this, a lack of gross negligence should not be found at the pleading stage. "Ordinarily, questions of gross negligence and willful or wanton conduct are for the [ ] [finder of fact] and are not susceptible of summary adjudication." *Brown v. United Water Del., Inc.*, 3 A.3d 272, 276 (Del. 2010). In *Brown*, a water company was being charged with gross negligence when a house burned down due to the inability of the fire department to use nearby fire hydrants (which were under the control of the water company). The water company had painted over one hydrant and did not properly maintain another. The Supreme Court found that summary judgment should have been denied because the

water company was on notice of the issue. *Id.*[9] Similar to the *United Water* case, the record in the instant action demonstrates notice to the Special Committee.

The Chancery Court stated that, "[g]iven the scope of Cravath's investigation, nothing in the facts pled indicated that it was unreasonable (let alone grossly negligent) for the Board to rely on the investigation or reach the conclusions it did in reliance on the investigation." Opinion at 6. The Chancery Court seemed convinced that the consideration of the Special Committee began and ended based on the number of documents reviewed, number of persons interviewed, number of meetings held and the like. However, this data provides no real basis for conclusion as to whether the Board was grossly negligent.

In considering the steps taken by the Special Committee, the Chancery Court stated, "[t]he Plaintiff asks that I look past the steps the Board took via the Special Committee to inform itself, and conclude that based on the existence of large settlements later in time, the Board must have been grossly negligent." Opinion at 23-24. But when the Chancery Court talks about looking "past the steps the Board took" it seems to be suggesting that the fact what counts is the skeleton of the investigation, not anything to do with the substance of the investigation. It

[9] As the Chancery Court recently recognized in *Andersen v. Mattel, Inc.*, 2017 Del. Ch. LEXIS 12 (Del. Ch. Jan. 19, 2017), while not being swayed by the quantities of pages reviewed or persons interviewed, "[p]laintiff's argument that the investigation was inadequate because the report was kept secret might carry more weight if Plaintiff had made a Section 220 demand." *Id.* at *11. While there was no report issued in this case, BNYM's decision to keep the substance if the "talking points" used to present to the Special Committee, provides the same effect.

assumes because Cravath reviewed 10,000 documents, interviewed 13 persons, and held several meetings with the Special Committee, including one where Cravath reviewed fewer than 30 documents (selected by Cravath out of the 10,000 initially reviewed by it) with the Special Committee, that the Special Committee must have had the information it needed to come to at least a colorable conclusion that there had been no wrongdoing. The issue is not that Plaintiff is protesting "the type of documents reviewed, or the choice of persons to be interviewed." Opinion at 26. The protest is with the facts revealed in the investigation.[10]

The problem here is that it is hard to imagine that reasonable minds can consider the underlying facts and come to a conclusion other than the demand was improperly refused. Indeed, in this action, there is no evidence that could colorably support a finding that nothing wrong was done.

b. Failure to Find and Report the Wrongdoing

In considering the settlement of the U.S. Action and admitted wrongdoing, the Chancery Court suggested that Plaintiff has not established gross negligence against the Special Committee and cites the magnitude of documents reviewed, interviews conducted and meetings between the Special Committee and Cravath. The Chancery Court acknowledged that "the Committee had before it certain 'bad' documents," but adds that "one would expect that in a presentation of its findings

[10] In considering whether a litigation demand was wrongfully refused, the focus should not be on the number of documents reviewed and witnesses interviewed. The focus should be the facts discerned from the material.

Cravath would put before the decision-maker the documents of greatest concern." Opinion at 29. The Chancery Court also suggested that is one piece of the process which the Special Committee must evaluate "along with *all* of the other work it or Cravath performed" and then reach a conclusion using business judgment. *Id.* While it is not unreasonable for Cravath to present one or more documents of concern, unless the Special Committee was grossly negligent, Cravath's pulling less than 30 out of 10,000 allegedly relevant documents and not be able to present one that supports an inference of no wrongdoing should have been a giant red flag.

Plaintiff is aware of the subject areas presented to the Special Committee because documents reflecting the talking points were made available to Plaintiff in heavily redacted format. *See, e.g.*, A-197 – A-233. While the subjects addressed do not necessarily seem unreasonable, there is no evidence that the Special Committee reasonably considered those subjects in refusing the Litigation Demand.

c. The Board's Failure to Identify Why Litigation Would Not Be in BNYM'S Best Interests Contradicts Appropriateness of Rejecting the Demand

As previously noted, the Demand Refusal stated that there was no sound legal basis to bring any claim and, even if there were, an action by BNYM was neither warranted nor in the best interests of BNYM. A-133; *see also* ¶¶ 184, 209. First, it makes no sense to state that it was not in the best interests of the Company to bring a claim when the Board did not even identify the potential claim or its

potential value. Second, and more importantly, the Chancery Court found that the investigation of the Special Committee was not grossly negligent even though neither the Special Committee nor the Board identified the reasons for its conclusion that litigation would not be in the corporation's best interest.

In *City of Orlando Police Pension Fund v. Page,* 970 F. Supp. 2d 1022 (N.D. Cal. 2013) ("*Page*"), the court, ruling under Delaware law, found refusal improper where the refusal letter merely said that litigation was not in the company's best interest "without explaining how the committee reached that conclusion." 970 F. Supp. 2d at 1031. Conversely, the court in *Freidman v. Maffei*, 2016 Del. Ch. 63 at *17, n.38, 45-46 (Del Ch. April 14, 2016), , granted a motion to dismiss pursuant to Rule 23.1, in part, because the board enumerated several reasons why it did not believe litigation was in the best interests of the company. While the *Page* court sustained the complaint, that board issued a 149 page report. In comparison, no report was issued by the Board herein.

d. The Chancery Court Failed to Draw All Inferences in Plaintiff's Favor

As noted above, the Court must draw all reasonable inferences in Plaintiff's favor. *Andreotti*, 2015 Del. Ch. LEXIS 135, at *84; *Brehm v. Eisner*, 746 A. 2d at 255 ("Plaintiffs are entitled to all reasonable factual inferences that logically flow from the particularized facts alleged, but conclusory allegations are not considered as expressly pleaded facts or factual inferences."). As discussed above, the

Complaint is replete with facts that demonstrate the board was grossly negligent if the inferences are drawn in Plaintiff's favor.

The fact that there were no documents of substance to support the Board's conclusion is significant. The ruling in *Louisiana Municipal Police Employees Retirement System v. Morgan Stanley & Co.*, 2011 Del. Ch. LEXIS 42 (Del. Ch. March 4, 2011) ("LAMPERS"), is demonstrative. LAMPERS filed a derivative case in federal court without making a litigation demand and the action was dismissed. LAMPERS then issued a litigation demand which was referred to the audit committee, and which, in turn, retained prominent counsel. As indicated in a refusal letter, counsel interviewed a number of people, reviewed at a "slew" of documents, pondered the law, and recommended that litigation be refused. The audit committee then "carefully" considered and approved the recommendation. The Board followed suit and refused the demand. LAMPERS then served a demand under Section 220. Following the company's refusal to produce documents, LAMPERS commenced an action for documents related to the board's investigation. In ordering documents produced regarding the investigative process, the Chancery Court explained why it was so important to consider the contents of the documents reviewed on behalf of the Special Committee, "The [litigation demand refusal] letter describes the Board's process, but it does not provide any substantive insight into the Board's decision." 2011 Del. Ch. LEXIS 42, at *21. It is those facts, as opposed to conclusions, that must be viewed in plaintiff's favor.

Thus, it is clearly important for a court in a derivative action to consider not just the recitation of the number of interviews, meetings and documents, but to consider facts uncovered in the documents as it related to the appropriateness of the board's demand response. Otherwise there would be no reason for Section 220 actions to exist as they relate to special committee or board investigations.

e. This Litigation Has Been Ongoing Since 2011, Another Demand Letter was Not Necessary

One of the factors that Plaintiff submitted to support a finding of gross negligence was the U.S. Action settlement acknowledging wrongdoing, admitting that customers did not understand the terms of the SI FX pricing, and the agreement to pay a hundreds of millions of dollars (in addition to the hundreds of millions of dollars paid in various other settlements with customers and other entities). Plaintiff cited *Page*, a case applying Delaware law, which sustained a derivative complaint where the corporation had entered into a consent order accepting responsibility for the wrongdoing and agreeing to pay a substantial fine. The Chancery Court rejected Plaintiff's use of *Page* and the fact that BNYM and Nichols had entered into a settlement and accepted responsibility.

In rejecting *Page* and the fact of the settlement, the Chancery Court indicated that it had already rejected *Page* in *Andreotti*, 2015 WL 2270673, at *24, 2015 Del. Ch. LEXIS 135 (Opinion at 24, n. 100). But a careful reading of *Andreotti* provides no clue that the Chancery Court rejected *Page* in terms of its

application of the law, only that it found the facts sufficiently distinguishable.

Indeed, one significant difference in *Andreotti* shows the board there was more thorough that the BNYM board. Unlike here, a 179 page report was prepared and circulated to the *Andreotti* board. 2015 Del. Ch. LEXIS 135, at * 6. The *Andreotti* court also discusses the Report in detail. In addition, the *Andreotti* committee, as opposed to the BNYM Special Committee, which provided nothing but bare conclusions, provided clear and detailed reasons as to why it did not pursue derivative claims:

> The [Andreotti] Committee ultimately concluded that "pursuing the [derivative] claims . . . is not in the best interests of the Company and its shareholders because (1) none of the claims has factual or legal merit; and (2) even if they did, the costs and risks of pursuing litigation far outweigh any potential benefit." In reaching that conclusion, however, the Report undertakes an examination of several categories of facts giving rise to potential causes of action, based on the December 2012 Stockholder Demand and the April 2013 Stockholder Demand: the development of Optimum GAT as a stand-alone product, the decision to pursue testing and commercialization of the stack, the management of the Monsanto Litigation, the Company's entrance into the RR2 Agreement that was part of the Monsanto settlement, the Company's disclosures relating to Optimum GAT, oversight claims, unjust enrichment, and legal malpractice by Company counsel in the Monsanto Litigation. The Committee also considered "other factors," which included indemnification and advancement, statutes of limitations, and the time, expense, and business impact of litigation.

2015 Del. Ch. LEXIS 135, at *57-58.

In contrast, the BNYM Special Committee's discussion about the reason for not bringing litigation is limited to the following conclusory language:

> As a result, the Special Committee determined and resolved to recommend to the Board that: (i) the Company has no sound legal basis to assert claims against any current or former director, office or employee of the Company in connection with any issue related to the Company's foreign exchange trading practices as raised in the March 9 and March 1 letters from counsel to Mr. Zucker; (ii) any such litigation would not be in the best interests of BNY Mellon and its stockholders in any event; . . .

While Plaintiff understands that the issue is not whether the decision made by a board of special committee was wise or whether others would reach the same conclusion, there needs to be an element that the decision was not so outside the realm of reasonableness. For example, in *Andreotti,* even if one disagreed with the conclusion of the special committee, it would be hard to argue the board's decision was not without some support. In that case, Plaintiff demanded that litigation be brought regarding the conduct that lead to a jury verdict against DuPont for $1.7 billion. The committee found that this was not a basis to bring litigation because the matter was on appeal and a resolution was reached on that claim. "The Committee found the detriment of the jury verdict, in light of the appeal and the Settlement, to be virtually zero." 2015 Del. Ch. LEXIS 135, at *102.

As in *Andreotti*, "One can dissent from that opinion without doubting the good faith of the Board's decision to rely on the recommendation of the Committee that it was not worthwhile to proceed with fiduciary duty litigation against 'at least some' employee or board member." *Id.* at *102. Unfortunately, the conclusory statements in the BNYM refusal letter, the universe of documents produced, and

the redactions in the "talking points" lead to the observation that there are just no "reasons discussed above" to look back on to determine if there is even a spark of reasonableness in the conclusion. *See, e.g., id.*

The Chancery Court also attempted to distinguish the *Page* case and avoid its application to the instant case on the basis that *Page* rejected the demand after the company had already forfeited a very large amount of money. Opinion at 24, n. 100. In contrast, BNYM made its admissions after the time it rejected the Litigation Demand. *Id.* Certainly, the Board, Special Committee and Cravath knew or should have known that BNYM had reason to anticipate new information resulting from the US Action and State of New York.

Even if the Special Committee did not exist at the time of the settlements with the United States and New York, there was no reformulation needed for the Board to give consideration. After all, the Special Committee was only a subcommittee of the Board, which was the vehicle ultimately responsible for making an appropriate response to the Litigation Demand – and this litigation has been consistently ongoing since 2011.

VI. ARGUMENT

A. Question Presented

Whether the Chancery Court erroneously permitted Defendants to use the attorney client privilege and work product immunity as a shield and a sword. Question Preserved at: A-249 – A-251.

B. Scope of Review

"Applicability of the attorney-client privilege and work product doctrine is reviewed *de novo*." *Gillen v. Cont'l Power Corp.*, 2014 Del. LEXIS 548, at *14 (Del. 2014).

C. Merits of Argument

Prior to filing the Complaint, Plaintiff issued the 220 Demand and participated in the 220 Trial. The 220 Trial was decided with the benefit of trial briefs, exhibits and the argument of counsel. After spirited argument and consideration by the Court, a ruling was made by the bench.

At the 220 Trial, one of the areas addressed by the Court was the extent to which, if at all, certain memos, used as an aid to counsel to present information to the Special Committee, need be produced. Such a memo is labeled [redacted] A-198 – A-233. Even a cursory review of this document demonstrates that it is almost redacted in its entirety except for most subject headings, including [redacted]

[redacted] *Id.* Despite the fact that these headings indicate that the Special Committee's discussion went to the heart of the Litigation Demand, made on behalf of the Company, Plaintiff was provided no access to the information discussed.

At oral argument on the motion to dismiss for this action and the related Kops' action, the Chancery Court questioned Kops' counsel why Kops did not move to compel after the 220 Trial because of the extensive redactions. Opinion at 31, n.121, *citing* Oral Arg. Tr. 71:8-20 (A-256). Kops' counsel responded, "I figured enough is enough already we need to proceed . . . and we'd get bogged down again for another year on that." *Id.* Considering BNYM made a considerable effort in opposition to the 220 Demand and Kops Demand to have the petitions denied based on the statute of limitations and laches, it was certainly reasonable to push forward. Although the Chancery Court deferred ruling on the statute of limitations and laches issues, it is quite reasonable to believe that whatever the strength of the argument to address the redactions, it was a certainty that if derivative complaints were filed, the filings would have been delayed and Defendants would raise the statute of limitation issue again and any merit of that argument would only be stronger.

There is a more fundamental reason for not moving to compel the removal of redactions. The issue of the production of the relevant documents was litigated in front of the Chancery Court in the 220 Trial. The issues were vigorously litigated, and Chancery Court made a ruling and was quite clear on what BNYM was required to produce and in what form. At the 220 Trial, after the Chancery Court issued its ruling, there was colloquy by both sides asking for clarification and guidance on the ruling. The Chancery Court, among other things, stated:

> I don't think it's necessary and essential to your purpose to know what Cravath learned in its investigation. I think it is necessary and essential to know the categories of information they presented to the board and what they conveyed to the board through the committee, because that is what affects whether this was a decision that was taken within their fiduciary duties or not.

A-180 at 14-21. After a little more colloquy, the Chancery Court clarified its explanation:

> But I am hopeful that it's clear what I'm trying to convey, which is if the committee was given information about a topic, you have a right to know that Cravath shared information about that topic with them. The substance of the investigation I don't think they need to disclose.

A-181 at 13-19. Thus, the issue is not about finding fault in Plaintiff's counsel for not seeking to remove redactions. A ruling was made, BNYM made redactions and statute of limitations arguments. Plaintiff believed the Litigation Demand had merit, needed to keep moving forward.

That said, a party cannot use the attorney-client privilege as both a shield from discovery and a sword in litigation. *In re Quest Software Inc. S'holder Litig.*,

2013 Del. Ch. LEXIS 167, at *7 (Del. Ch. July 3, 2013) ("a party cannot use the attorney-client privilege as both a 'shield' from discovery and a 'sword' in litigation") (*citing Ashmore v. Metrica Corp.*, 2013 Del. Ch. LEXIS 167, at * 7 (Del. Ch. May 11, 2007); *Sealy Mattress Co. NJ, Inc. v. Sealy, Inc.*, 1987 Del. Ch. LEXIS 451, 1987 WL 12500, at *6 (Del. Ch. June 19, 1987) . Thus, having taken the position that it rightfully did not want to waive privilege or immunity, and in effect hiding material contained in the redacted memo, BNYM should not be allowed to use the redactions to tell a story consistent with Defendants' narrative that the Special Committee did not uncover wrongdoing.

With a field of otherwise damning facts in the record, the idea that the redacted material would similarly be consistent with wrongdoing is a logical conclusion. Thus, it was error for the Chancery Court to find that Plaintiff was at fault for not further pursuing the removal of the redactions from the "talking points" documents and let Defendants use privilege as a sword. Instead, the Chancery Court should have inferred that the redacted materials contained facts that would add to the wealth of information showing the Alleged Wrongdoing and the Special Committee's gross negligence in refusing the Litigation Demand.

As an analogy, under Delaware law, an inference may be drawn against Defendants as a result of the assertion of privilege. For example, in *Hecksher v. Fairwinds Baptist* Church, 2013 Del. Super. LEXIS 4062 (Del. Super. Feb. 28, 2013), in connection with a civil litigant invoking the Fifth Amendment, the Court

stated, "[i]t is a 'prevailing rule that the Fifth Amendment does not forbid adverse inferences against parties to civil actions when they refuse to testify in response to probative evidence offered against them: the Amendment 'does not preclude the inference where the privilege is claimed by a party to a Civil cause.'" *Id.* at *1, *quoting Baxter v. Palmigiano*, 425 U.S. 308, 318 (1976).

VII. CONCLUSION

For the foregoing reasons, Plaintiff respectfully requests that the decision and order of the Chancery Court be reversed and the action remanded.

BIGGS & BATTAGLIA

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