Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—S.D.N.Y.: Court approves $218-million JPMorgan settlement in Madoff litigation, (Mar. 24, 2014)

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By Amanda Maine, J.D.

A federal court has approved a settlement of $218 million between class action plaintiffs and JPMorgan relating to Bernard Madoff's Ponzi scheme. The class action had alleged that JPMorgan had ignored red flags and profited from the scheme. The court found the settlement to be fair, reasonable, and accurate. The court also approved the certification of the class and awarded attorneys' fees to plaintiffs' counsel (*Shapiro v. JPMorgan Chase & Co., et al.*, March 21, 2014, McMahon, C.).

Background. Bernard Madoff was arrested in December 2008 for perpetrating what turned out to be the largest Ponzi scheme in U.S. history. Starting in 1986, funds of Bernard L. Madoff Investment Securities LLC (BLMIS) held a depository account at JPMorgan through which most of its funds flowed. According to the class action complaint, JPMorgan knew about Madoff's scheme but did nothing to stop it. Although it was BLMIS's primary account, none of the money in the account was ever used to purchase a security. The plaintiffs alleged that Madoff refused JPMorgan's efforts to perform due diligence on BLMIS and that BLMIS feeder funds did not permit access to the agreements they had with Madoff. JPMorgan also raised questions about BLMIS's auditor, who was not registered with the PCAOB or subject to AICPA peer reviews.

JPMorgan employees attempted to recreate Madoff's impressive investment returns without success in addition to raising concerns within JPMorgan. JPMorgan ignored these "obvious red flags," allowing the scheme to continue despite its duties and regulatory obligations, according to the plaintiffs. JPMorgan redeemed over $250 million of its own interests in BLMIS feeder funds while BLMIS customers lost nearly $18 billion. Investors who lost money in the scheme filed lawsuits against Madoff, BLMIS, and several other entities, including JPMorgan.

Settlement and *Grinnell* factors. A class-action settlement with JPMorgan of $218 million for its Madoff-related activities was submitted to the court for approval. The court evaluated whether the settlement was "fair, reasonable, and accurate" according to the factors outlined in *City of Detroit v. Grinnell Corp.* (2d Cir. 1974). These factors are: (1) the complexity, expense, and likely duration of the litigation; (2) the reaction of the class to the settlement; (3) the stage of the proceedings and the amount of discovery completed; (4) the risks of establishing liability; (5) the risks of establishing damages; (6) the risks of maintaining the class action through the trial; (7) the ability of the defendants to withstand a greater judgment; (8) the range of reasonableness of the settlement fund in light of the best possible recovery; and (9) the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant litigation risks.

The court first determined that the complexity, expense, and likely duration of the litigation supported approval of the settlement. In the absence of a settlement, litigation could continue for years and be incredibly costly in terms of time and expenses of discovery, trial, and likely appeals. In contrast to litigation, the settlement would provide an immediate cash payment to the class, the court stated.

The court next advised that the "overwhelming support" by the class of the settlement is strong evidence that the proposed settlement was fair. The court pointed out that of nearly 2,800 notices sent out, only 10 opt-outs were filed, and most of those were by investors who had not experienced actual losses.

The court also found that at this stage of the proceedings and the extent of the discovery, the plaintiffs had enough information to evaluate the strengths and weaknesses of continuing litigation. Regarding the risks of establishing liability, the court advised that a settlement at this point would be beneficial to the plaintiffs given the complex and novel issues of fact and law that could arise under litigation, as well as the difficulty of proving aiding-and-abetting liability. Similarly, proving damages in complex class actions would be difficult and most likely require expert testimony, so approval of the settlement was warranted under the damages prong.

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The possibility of decertification also favors settlement, the court stated, noting that courts can exercise their discretion to reevaluate the appropriateness of class certification.

Evaluating the range of reasonableness of the settlement fund in light of the best possible recovery, the court noted that approving the settlement would result in an immediate distribution of $218 million to the class, rather than a “speculative payment many years down the road.” The court also found that JPMorgan could withstand a judgment greater than the amount proposed by the settlement, and that its financial circumstances did not ameliorate the force of the other *Grinnell* factors.

Regarding the settlement’s reasonableness in light of possible recovery through litigation, the court addressed a party’s objection that the settlement does not consider continued litigation costs stemming from separate actions brought by the SIPA trustee against other financial institutions, and that it ignores possible consequences of JPMorgan’s deferred prosecution agreement. The court rejected this argument, explaining that under *Grinnell* courts look to the continued litigation in the case at issue and not at separate actions that involve different parties.

Certification. The court also determined that the certification of the settlement class was appropriate. As the class consists of over 2,000 individuals and entities all over the world, members were too numerous to be joined and doing so would be impracticable. The class members had numerous issues of law and fact in common, including JPMorgan’s duties owed to the plaintiffs, whether JPMorgan aided and abetted BLMIS’s theft, and the damages the plaintiffs suffered. The claims of the class were typical, because they stemmed from the same course of JPMorgan’s conduct. A class action was the superior method of adjudication, the court advised, citing the scope and complexity of the potential claims against JPMorgan and the probable high cost of individual litigation.

Attorneys’ fees. Finally, the court determined that co-lead counsel was entitled to an award of attorneys’ fees and expenses of $18 million in connection with the settlement. The proposed fees payment will not come from the $218-million settlement; JPMorgan will pay them separately, the court noted. The fees amounted to 7.6 percent of the settlement total, when reasonable fees can reach as high as 30 percent, the court observed. The court found the fees reasonable given the time and labor expended by counsel and the complexity and magnitude of resolving claims involving the largest Ponzi scheme in history. It also stated that the law firms representing the plaintiffs, Entwistle & Cappucci LLP and Hagens Berman Sobol Shapiro LLP, have extensive experience in complex litigation and meet the “quality of representation” factor justifying the imposition of attorneys’ fees.

The case is No. 11 Civ. 8331.

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Companies: Dichter-Mad Family Partners, LLP; JPMorgan Chase & Co.; JPMorgan Chase Bank, N.A.; J.P. Morgan Securities LLC; J.P. Morgan Securities, Ltd.; Bernard L. Madoff Investment Securities LLC

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