Board Of Trustees Of The AFTRA Retirement Fund et al v. JPMorgan Chase Bank, N.A. Doc. 92

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

BOARD OF TRUSTEES OF THE AFTRA RETIREMENT FUND, in its capacity as a fiduciary of the AFTRA Retirement Fund, individually and on behalf of all others similarly situated, Plaintiff, v. JPMORGAN CHASE BANK, N.A., Defendant.	Consolidated as Civil Action No. 09-00686 (SAS) (DF) ECF Case
BOARD OF TRUSTEES OF THE IMPERIAL COUNTY EMPLOYEES' RETIREMENT SYSTEM, in its capacity as a fiduciary of the Imperial County Employees' Retirement System, individually and on behalf of all others similarly situated, Plaintiff, v. JPMORGAN CHASE BANK, N.A., Defendant.	
THE INVESTMENT COMMITTEE OF THE MANHATTAN AND BRONX SURFACE TRANSIT OPERATING AUTHORITY PENSION PLAN, in its capacity as a fiduciary of the MaBSTOA Pension Plan, individually and on behalf of all others similarly situated, Plaintiff, v. JPMORGAN CHASE BANK, N.A., Defendant.	

PLAINTIFFS' OMNIBUS BRIEF IN OPPOSITION TO DEFENDANT'S MOTION FOR PARTIAL SUMMARY JUDGMENT AND IN SUPPORT OF PLAINTIFFS' CROSS-MOTION FOR PARTIAL SUMMARY JUDGMENT

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I. INTRODUCTION

As Judge Learned Hand recognized long ago, "[t]he most fundamental duty owed by [a] trustee to the beneficiaries of the trust is the duty of loyalty.... We should even be disposed to say that without this duty there could be no trust at all."[1] A fiduciary is obligated to act with undivided loyalty, free from conflicting personal interest, and must be guided by the best interests of the beneficiaries at all times. Given these stringent fiduciary obligations, which the Second Circuit has characterized as "the highest known to the law,"[2] it is axiomatic that a fiduciary is "strictly prohibited from engaging in transactions that ... involve or create a conflict between the trustee's fiduciary duties and personal interests."[3] Indeed, "the duty of a trustee not to profit at the possible expense of his beneficiary is the *most fundamental of the duties* which he accepts when he becomes trustee."[4]

The actions of defendant JPMorgan Chase Bank, N.A. ("JPMorgan") in this case reflect a blatant disregard of this fundamental duty. The undisputed record evidence establishes that JPMorgan knowingly and intentionally enriched itself despite having actual knowledge that its actions would substantially impair the financial interests of the Class.

In February 2008, eight months *after* it purchased for the Class $500 million of medium-term notes ("MTNs") secured by the assets of Sigma Finance ("Sigma"), an off-shore structured investment vehicle ("SIV"), JPMorgan secretly began providing repurchase ("repo") financing to Sigma. Long before extending such financing, JPMorgan concluded that Sigma would likely fail; rather than being a disincentive, Sigma's expected failure made the repo financing

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[1] *Dabney v. Chase Nat'l Bank of City of N.Y.*, 196 F.2d 668, 670 (2d Cir. 1952).

[2] *Donovan v. Bierwirth*, 680 F.2d 263, 272 n.8 (2d Cir. 1982).

[3] RESTATEMENT (THIRD) OF TRUSTS § 78(2).

[4] *Dabney*, 196 F.2d at 670 (emphasis added).

especially attractive because it allowed JPMorgan to purchase high-quality assets in large blocks at deep discounts or, in JPMorgan's own words, to capitalize on "*very big money making opportunities [] as the market deteriorates*." (Ex. 10)

JPMorgan's decision to enrich itself by providing repo financing to Sigma rose to the highest levels of the bank, including direct involvement by Jamie Dimon. JPMorgan ultimately extended $8.4 billion in repo financing but, as result of substantial "haircuts," acquired more than $9.3 billion of Sigma's best assets for itself. In so acting, JPMorgan knew that its actions would materially impair the value of the MTNs it held for the Class when Sigma failed.[5]

Given this knowledge, what conflict analysis did JPMorgan undertake to determine whether its provision of repo financing to Sigma could be reconciled with the stringent fiduciary obligations it owed its fiduciary clients? None.

Presumably, any such analysis would have considered whether disclosure should be made to ameliorate the effects of the conflict. This is particularly relevant here given that (i) JPMorgan's own expert testified that JPMorgan's status as a repo financier was *not* material non-public information and (ii) JPMorgan's *August 2007* conclusion that the SIV sector would fail was based entirely on publicly available information. Thus, the critical information that the Class needed to know in order to protect its interests – *i.e.*, JPMorgan's status as repo financier and its conclusion that SIVs (including Sigma) would fail – notably was *not* material non-public information subject to disclosure restrictions.

But what did JPMorgan disclose to the Class about its role in taking title to more than $9.3 billion of Sigma's best assets? Nothing. And what of its conclusion that Sigma would

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[5] JPMorgan's argument that it would not have extended repo financing had it believed that Sigma would fail (JPM Mem. at 7-9) is not remotely credible given the overwhelming evidence to the contrary and, at best, would present an issuer for the trier of fact.

likely fail, at which point the assets JPMorgan had seized would not be available to support the MTNs of the Class? Not a word. Instead, JPMorgan surreptitiously took advantage of what it presciently described as "very big money making opportunities" in the market as the SIV sector deteriorated, extracting nearly $230 million in repo fees and taking title to more than $9.3 billion of Sigma's best assets, all while continuing to hold the $500 million of MTNs for the Class.

In September 2008, JPMorgan declared Sigma in default of the repo agreements and forced it into receivership. From subsequent asset sales and improvements in the market, JPMorgan ***made nearly $1.7 billion of profit for itself*** on Sigma assets; in contrast, the Sigma MTNs that it continued to hold for the Class are now worth less than six cents on the dollar.

In clear breach of its fiduciary obligations, JPMorgan poached Sigma's best assets for itself at favorable prices despite knowledge that its conduct would materially impair the financial interests of the Class when Sigma eventually collapsed. JPMorgan made no disclosure to the Class that would allow them to protect their interests. Nothing about its status as a multi-faceted financial institution allows JPMorgan to so blithely disregard the highest duties known to law. Accordingly, JPMorgan's motion for summary judgment should be denied and plaintiffs' cross-motion should be granted.[6]

II. STATEMENT OF FACTS

On June 4, 2007, JPMorgan, acting in a fiduciary capacity as investment manager, purchased $500 million of Sigma MTNs on behalf of the Class. *See* JPMorgan's Rule 56.1

[6] In addition to seeking summary judgment on Count II of the complaint filed by AFTRA, JPMorgan purports to seek judgment on Counts I and III of the complaints filed by Imperial County and MaBSTOA (JPM Mem. at 1). However, Counts I and III of the Imperial County and MaBSTOA complaints (asserting claims for breach of fiduciary duty and breach of contract, respectively) are *not* limited to the duty of loyalty claim on which JPMorgan seeks judgment but also allege liability based upon the independent duty of prudence. Accordingly, there is no basis to dismiss those counts in their entirety regardless of how the Court resolves JPMorgan's motion.

Statement ("JPM St.") ¶ 7. The two-year MTNs, which were scheduled to mature on June 4, 2009, were secured by a floating first priority lien on all of Sigma's eligible assets. *See id.; see also* Ex. 1. Notwithstanding the floating first priority lien, Sigma retained the right to enter into repo financing agreements under which it could transfer title of specific assets to repo financiers; the repo financiers would have a superior interest on those specific assets and, in an event of default, those assets would not be available to support the MTNs. Ex. 1.

A. JPMorgan Predicts the Demise of the SIV Sector and Establishes A Team to Identify and Execute on Profit Opportunities for Itself

Within three months of the $500 million purchase, experts at JPMorgan predicted that the SIV sector, including Sigma, would collapse and recommended the establishment of a team to allow JPMorgan to identify and capitalize on resultant profit opportunities.

On August 23, 2007, John Kodweis, head of Short-Term Fixed Income Origination (a JPMorgan department that had originated Sigma's MTN program for a decade), sent an email to high-ranking JPMorgan officials that contained the following conclusions and recommendations:

> We think the current liquidity squeeze on the Structured Investment Vehicles is *unlikely to abate….* Although the environment remains unpredictable, we now think it possible – even *probable – that the entire sector unwinds….*
>
> To date, JPM's efforts to aid the SIV managers has been a loosely coordinated effort among the various product teams that have traditionally done business with them…. *The bigger opportunity may well be in managing their potential wind-down and exit from the short-term debt markets, as almost $400 billion of high-grade assets are shifted.*
>
> We may be too early on this, but we believe it would make sense for JPMorgan to *establish a team* that would be charged with working through this issue, in particular … *identifying profit opportunities in portfolio sales or restructuring [and] identifying opportunities to buy assets that demonstrate a very attractive risk/reward profile for JPM – given the potential for forced selling….*
>
> [The rating agencies] are considering allowing SIVs to repo

> securities, which we believe is an allowance made only under extraordinary circumstances. (*We do not believe this works in any meaningful way.*)

Ex. 2 (emphasis added). In the same email, Kodweis listed JPMIM (a group that includes securities lending) as one of the top 12 investors in the SIV market. *Id.; see also* Ex. 3 (Kodweis Tr. at 141-42). Importantly, Kodweis testified that, in concluding the SIV sector would unwind and that repo financing of SIVs did not work in any meaningful way, neither he nor his team relied upon *any* non-public material information. *See* Ex. 3 (Kodweis Tr. at 140, 164-65).

Within a week of the Kodweis email, JPMorgan established a broad-based team – which included Kodweis and Lisa Shin (the credit analyst responsible for the Sigma MTNs JPMorgan held for the Class) – to "analyze a potential unwind of SIVs scenario." *See* Ex. 4 at JPMC294233. Jamie Dimon, JPMorgan's CEO, was interested in learning from the team "the systemic risk of a complete unwind of all SIVs," including "the time frame each [SIV] can operate," how all parties are paid, and "what it takes for [SIVs] to have an orderly unwind and over what time frame ... this take[s] place." *Id.* at JPMC400693.

From the start, Dimon was keenly interested in Sigma's assets. For instance, in an August 30, 2007 email requesting that she gather SIV materials for Dimon, Shin was directed to include "a very real picture of the assets that will be unwound *with particular focus on Sigma* (best we can do)." *Id.* at JPMC400692 (emphasis added). The following day, Dimon received a packet of information concerning SIVs; the cover memo *specifically directed him to information on Sigma's assets*. *Id.* at JPMC400602. *See also* Ex. 5 ("[W]e need to remember that Bill [Winters]/Jamie [Dimon] want the assets at this point.").

No recommendation was made to evaluate the impact of the predicted SIV sector failure on JPMorgan's fiduciary clients.

B. JPMorgan Extends Repo Financing to Sigma With the Expectation of Obtaining High Quality Assets at Substantial Discounts When Sigma Inevitably Fails

Within weeks of Kodweis' email, JPMorgan seriously began to consider providing repo financing to Sigma, an arrangement that would allow it to select and take title to the best assets in Sigma's portfolio. Although Dimon and top officials were aware of the conflict that providing repo financing to Sigma would create with the Class, they focused their efforts strictly on maximizing the potential "profit opportunity" for JPMorgan presented by Sigma's troubles.

JPMorgan's team carefully reviewed Sigma's portfolio and selected the securities that would be part of the repo transaction. *See, e.g.,* Ex. 6 (America Tr. at 70-79). Notably, during its pre-financing due diligence, JPMorgan concluded that Sigma would *not* likely survive as a going-concern. A February 6, 2008 email between senior JPMorgan officials – sent prior to the first repo agreement with Sigma – contained the following acknowledgement:

> The credit meeting yesterday maintained the view Sigma may survive as a going concern but *this is unlikely* (and even more unlikely given the recent FSA document giving the principle that liquidity facilities will attract a higher capital charge). However, the likely scenario remains an orderly wind down (TBC) and therefore a trade of this nature can still be absolutely viable as long as the market & legal/reputational risks are fully understood upfront and *the P&L [profit and loss] justifies this.*

Ex. 7 at JPMC158069 (first emphasis added; second emphasis in original). *See also id.* at JPMC158043 ("By having control over assets in the portfolio there is a significant P&L opportunity should Sigma unwind as we retain 'last look' on the assets….").

One week later, on February 14, 2008, JPMorgan and Sigma executed a repo financing agreement for $5 billion (named "Clovehitch I"). *See* Ex. 8. JPMorgan demanded and received significant contractual protections for itself, including application of a substantial "haircut" to the market value of assets it purchased from Sigma, providing substantial "over-collateralization" of

its position.[7] *See id.* As a result of the "haircut," JPMorgan provided $5 billion in financing but took title to more than $5.4 billion in market value of Sigma's best assets.[8]

Within weeks of executing Clovehitch I, JPMorgan saw an opportunity to obtain even more assets from Sigma under favorable terms. In an email string from early March 2008, Mark Crawley of the investment bank wrote to Cox:

> There may be an opportunity to use this current volatility to do more repo trades with them which are in effect asset financing at very attractive levels on high quality assets with excellent structural protection (*i.e.*, lever the structure we have put in place but *treat it as a trade rather than 'support' for [S]igma*)....
>
> This strikes me as an opportunity for collaterali[z]ed lending using robust docs from the [S]igma process and good assets. If we can keep a good discipline here then there are *very big money making opportunities I think as the market deteriorates* ... but I would appreciate your thoughts on *the 'grand scheme' within JPM.*

Ex. 10 at JPMC158401-02 (emphasis added).[9] *See also id.* at JPMC158636 (providing Sigma with additional funding provides JPMorgan with the opportunity "to buy high quality assets in large blocks at deep discounts if Sigma defaults").

Seeking to capitalize on these "very big money making opportunities," JPMorgan thereafter entered into three additional repo arrangements with Sigma: Clovehitch II (executed on June 28, 2008 for $6 billion); Selenium (executed on July 8, 2008 for $1.5 billion); and Clovehitch III (executed on August 28, 2008 for $1 billion). *See* JPM St. ¶ 13; *see also* Exs. 11-12. As of September 2008, JPMorgan had extended $8.4 billion of repo financing to Sigma but,

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[7] A "haircut" is a percentage discount that the lender applies to the market value of a repoed asset, providing the lender with additional protection in the event that the value of the asset declines. *See, e.g.,* Ex. 9 (Glasgow Tr. at 119-20).

[8] In this way, repo financing with haircuts has materially different consequences for noteholders of the repo borrower than does secured lending. Not only does the repo lender take title (rather than a security interest) to specific assets but it takes *more* assets than the amount of financing.

[9] In the same email string, Cox again noted JPMorgan's view that Sigma would collapse: "They have more repo than we thought but this was always going to be a race against time...." *Id.*

as a result of substantial "haircuts," had taken title to nearly $9.4 billion of Sigma's best assets. *See* JPM St. ¶ 13; JPM Ex. M ¶¶ 5-7; Exs. 11-12. Thus, in addition to having "cherry-picked" the best assets from Sigma's portfolio, JPMorgan secured title to assets worth nearly a billion dollars more than the amount of financing it provided.[10]

C. JPMorgan Fails to Analyze the Conflict or Make Disclosures to the Class

Long before it first extended repo financing to Sigma, JPMorgan had actual knowledge of the conflict with the Class that would result, including knowledge that its actions would seriously impair the value of the Class' MTNs when Sigma failed. Notwithstanding such knowledge, JPMorgan failed to analyze the conflict or disclose material information to the Class.

The undisputed evidence establishes that Dimon knew JPMorgan's fiduciary clients owned Sigma MTNs at the time JPMorgan was considering whether to extend repo financing to Sigma. Sandra O'Connor, the JPMorgan executive in charge of the securities lending business, testified that Dimon knew that securities lending held Sigma MTNs for the Class; she regularly reported to Dimon about her department's substantial exposures, which included the Sigma MTN investments. *See* Ex. 13 (O'Connor Tr. at 52-61).

Other high-ranking JPMorgan officials were equally aware. On September 18, 2007, Andrew Cox (chief credit officer) sent an email to Bill Winters (then-head of the investment bank) and John Hogan (then-chief risk officer of the investment bank), among others, discussing a proposal for JPMorgan to extend repo financing to Sigma. *See* Ex. 14. In recommending *against* the proposal, Cox explicitly raised the potential firm-wide conflict of interest inherent in any arrangement: "I have heard JPM Asset Mgmt are large buyers of SIV and Sigma CP. Do we

[10] JPMorgan's contention that other entities also provided repo financing to Sigma (JPM Mem. at 6) is inconsequential given that none of those entities owed fiduciary obligations to the Class. Regardless, JPMorgan was by far Sigma's largest repo financier. *See* JPM St. ¶ 14; JPM Ex. J.

need to consider the firmwide position? This is most acute with the largest independent SIV manager." *Id.* In response, Hogan – the *chief risk officer* of the investment bank – told Cox that "we need to protect our position irrespective of the broader 'break the buck' issue or worry about [what] JPM Asset Mgmt has invested in." *Id.*

JPMorgan was also aware that: (1) Sigma was only funded one week in advance and, thus, was in a precarious financial position (Ex. 15); and (2) that repo "creates a super senior (secured) class above senior MTNs" and "[i]n the worst case scenario of an event of default … the repo counterparties would seize the collateral pledged under repo, and those assets would not be available for the benefit of senior noteholders" (Ex. 16 at JPMC402205).

At the time it extended repo, JPMorgan was thus aware of the MTNs it was holding for the Class and of the factual predicate for the obvious conflict of interest that its actions caused. Despite such knowledge, JPMorgan undertook ***no effort*** to analyze or evaluate the conflict of interest. Andrew Cox, JPMorgan's Rule 30(b)(6) corporate designee, testified that JPMorgan conducted no conflict analysis whatsoever:

> Q: Can you describe for me what analysis JPMorgan engaged in to determine what effect the provision of repo financing would have on its other clients?
>
> A. We did none.

Ex. 17 (Cox Tr. at 86-88).

It is equally undisputed that JPMorgan never disclosed to the Class that it was providing repo financing to Sigma. *See* Ex. 13 (O'Connor Tr. at 165).

D. JPMorgan Declares Default, Makes Billions of Dollars for Itself, and Causes the Sigma MTNs to Become Essentially Worthless

On September 30, 2008, after Sigma failed to satisfy one of JPMorgan's own margin calls, JPMorgan declared Sigma in default of all repo agreements. *See* JPM St. ¶ 22; Ex. 18

(Cox Tr. at 187-90). The effect on Sigma was immediate and dramatic: The following day, Sigma ceased all trading activities and entered receivership. *See* JPM St. ¶ 23.

JPMorgan's declaration of default and Sigma's subsequent receivership decimated the Class' MTNs, which are now worth less than six cents on the dollar. *See* Ex. 19 (Shin Tr. at 345). In striking contrast, JPMorgan made ***billions of dollars for itself***. In addition to receiving more than $228 million in repo fees,[11] JPMorgan reaped nearly $1.7 billion in profits on the Sigma assets it seized. Internal documents establish that JPMorgan made more than *$470 million in profit* on sales of Sigma assets in the 12-month period following default.[12] Additionally, the assets that JPMorgan seized from Sigma but did not sell during that 12-month period have *increased in value by nearly $1.2 billion.*[13] JPMorgan thus made $228 million for itself in fees; made $470 million for itself in asset sales from October 2008 through September 2009; and held assets that have appreciated in value by an additional $1.2 billion. In contrast, JPMorgan left the Class, to which it owed the "highest duties known to law," with a loss exceeding half a billion dollars.

As JPMorgan had predicted, there were indeed "very big money making opportunities" arising from Sigma's collapse. But JPMorgan was not entitled to exploit those opportunities to enrich itself knowing that its conduct would directly and materially impair the financial interests of its fiduciary clients. In contravention of its stringent obligations, JPMorgan intentionally

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[11] *See Bd. of Trs. of the AFTRA Ret. Fund v. JPMorgan Chase Bank, N.A.*, 269 F.R.D. 340, 345 (S.D.N.Y. 2010).

[12] At default, JPMorgan provided Sigma with schedules of assets from Clovehitch II and III that, among other things, identified JPMorgan's stated value for each asset. *See* Exs. 20-21. JPMorgan also provided information about sales (for the 12-month period following default) of all assets that JPMorgan had seized from Sigma. *See id.* A comparison of the values JPMorgan assigned to the Clovehitch assets at closeout versus the prices at which JPMorgan sold many of those same assets reveals that JPMorgan made a profit of approximately $470 million.

[13] Nearly all of the Clovehitch II assets are publicly-traded bank debt with well-recognized market values. *See* Ex. 20 at JPMC378254.

placed itself in a position of direct and irreconcilable conflict with the interests of the Class; it failed to make any inquiry into the conflict and failed to disclose its conflicted status to the Class; it made decisions and took actions to protect its interests at the direct expense of its beneficiaries; and it profited handsomely from Sigma's default.

III. LEGAL ARGUMENT

Nothing about JPMorgan's status as a diversified financial institution or the purported existence of a "Chinese wall" authorizes JPMorgan to so cavalierly disregard its duty of loyalty and to profit at the direct expense of the Class. Despite the clear requirements imposed by ERISA and New York common law, JPMorgan (1) failed to disclose material information to the Class; and (2) intentionally undertook to poach Sigma's assets with full knowledge that its action would detrimentally impair the MTNs owned by the Class. Because the record overwhelmingly establishes that JPMorgan breached its duty of loyalty, plaintiffs are entitled to judgment as a matter of law and defendant's motion should be denied.

A. JPMorgan Breached Its Duty of Loyalty By Failing To Disclose Material Information to the Class

"The duty to disclose material information 'is the core of a fiduciary's responsibility.'" *Bixler v. Central Pa. Teamsters Health & Welfare Fund*, 12 F.3d 1292, 1300 (3d Cir. 1993) (quoting *Eddy v. Colonial Life Ins. Co.*, 919 F.2d 747, 750 (D.C. Cir. 1990)). The scope of the duty to disclose "is defined by what a reasonable fiduciary, exercising 'care, skill, prudence and diligence,' would believe to be in the best interest of the beneficiary to disclose." *Glaziers and Glassworkers Union Local No. 252 Annuity Fund v. Newbridge Secs., Inc.*, 93 F.3d 1171, 1180 (3d Cir. 1996) (quoting 29 U.S.C. § 1104(a)).

At a minimum, a fiduciary has a duty to disclose "those material facts, known to the fiduciary but unknown to the beneficiary, which *the beneficiary must know for its own*

protection." *Id.* (emphasis added). *See also In re Beacon Assoc. Litig.*, --- F. Supp. 2d ----, 2010 WL 3895582 at *31 (S.D.N.Y. 2010) (relying on *Glaziers*); *In re Bausch & Lomb Inc. ERISA Litig.*, No. 06-CV-6297, 2008 WL 5234281 at *9 (W.D.N.Y. Dec. 12, 2008); RESTATEMENT (THIRD) OF TRUSTS § 78(3) ("[A] trustee has a duty … to communicate to the beneficiary all material facts the trustee knows or should know in connection with the matter.").

Here, long *after* it purchased the Sigma MTNs for the Class, JPMorgan secretly began providing repo financing to Sigma, having predicted that Sigma would likely fail, and knowing that it would be taking title to more than $9.3 billion of Sigma's best assets that would be not be available to support the Class' MTNs when Sigma eventually failed.

Yet it is undisputed that JPMorgan said nothing to Class members. *See* Ex. 13 (O'Connor Tr. at 165). Class members were therefore unaware of JPMorgan's conflicted status and unable to take steps to protect their interests, such as demanding that JPMorgan (i) make them whole by taking the Sigma MTNs onto its books or (ii) sell the MTNs (at the time it began providing repo to Sigma, JPMorgan valued the Class' MTNs at 97.3% of par (Ex. 22)). At an absolute minimum, the Class would have been able to critically examine JPMorgan's statements about Sigma in light of its conflicted position and make an informed decision as to how to proceed. As a result of JPMorgan's failures, however, the Class never had that opportunity. Because JPMorgan's failure to disclose precluded the Class from taking steps to avoid or ameliorate the deleterious effects of the conflict, JPMorgan clearly breached its duty of loyalty.

Tellingly, JPMorgan does not address its fiduciary duty to disclose material information sufficient for the Class to protect its interests. But neither of its two merits arguments obviates its disclosure obligations or otherwise excuses its disloyal conduct in this case.

1. JPMorgan's "Non-fiduciary Capacity" Argument is Without Merit

JPMorgan first contends that it was acting in a non-fiduciary capacity when providing repo financing to Sigma. *See* JPM Mem. at 10-17. But even if this were true – which, as set forth *infra* in Section III.C, it is not – both New York law and ERISA require a fiduciary to disclose the existence of actual or potential conflicts *even where those conflicts arise from non-fiduciary activities*. The cases upon which JPMorgan principally relies make this point clear.

In *EBC I v. Goldman, Sachs & Co.*, 5 N.Y.3d 11 (2005), cited by JPMorgan, eToys alleged that Goldman Sachs, which advised it on the price for its IPO, was operating under a conflict because Goldman had undisclosed contractual arrangements with its clients under which it would share profits made on post-IPO sales of eToys stock. *Id.* at 18. Although holding that Goldman's fiduciary status was limited to its role as advisor (*see id.* at 22) – and thus would not include Goldman's contractual arrangement with clients – the New York Court of Appeals found that "Goldman Sachs breached [its] duty by allegedly concealing from eToys its divided loyalty arising from its profit-sharing arrangements with clients." *Id.* at 20.

Accordingly, even though Goldman's contractual arrangements with clients were non-fiduciary in nature, the existence of such arrangements obligated Goldman to disclose its conflicted status to eToys when acting in a fiduciary capacity. The Court held that eToys properly stated a claim for breach of fiduciary duty based upon *defendant's failure to disclose a material conflict of interest arising from its non-fiduciary contractual arrangements* with clients. *EBC I* is thus squarely on point with the situation here.[14]

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[14] At the pre-motion conference, JPMorgan's counsel attempted to distinguish *EBC I* by arguing that the same individuals at Goldman were allegedly involved in both activities. But there is nothing in the decision to support that contention and, even if true, the Court did not rely upon this point or limit its holding to situations where the same personnel are directly involved in both fiduciary and non-fiduciary activities; instead, it focused on *Goldman's* involvement.

ERISA compels the same result. In *Pegram v. Herdrich*, 530 U.S. 211 (2000), also cited by JPMorgan, the Supreme Court expressly recognized that an ERISA fiduciary may be required to disclose conflicts of interest that arise in a non-fiduciary capacity. Despite concluding that the eligibility/treatment decisions at issue were *non*-fiduciary in nature, the Court found that the defendant might have been obligated to disclose information about the plan that affected the beneficiaries' interests, recognizing that the "fiduciary duty to disclose is not necessarily coextensive with fiduciary responsibility for the subject matter of the disclosure." *Id.* at 227 n.8 (citing *Glaziers*). In other words, the *Pegram* Court recognized that the scope of a fiduciary's duty to disclose material information is not strictly limited to its fiduciary activities; instead, ERISA requires the disclosure of *all* information known by the fiduciary that may materially affect the beneficiaries' interests.

Moreover, even if JPMorgan was acting in a non-fiduciary capacity when extending repo financing to Sigma, it retained institutional knowledge of its conduct as repo financier when it again wore its fiduciary "hat" and was obligated to take steps to protect the Class, including disclosure of its conflicted position. As Judge Cote held in *In re WorldCom, Inc.*, 263 F. Supp. 2d 745 (S.D.N.Y. 2003), an ERISA fiduciary does not "forget" information obtained in its non-fiduciary capacity when subsequently acting in a fiduciary role: "When a corporate insider puts on his ERISA hat, he is not assumed to have forgotten adverse information he may have acquired while acting in his corporate capacity." *Id.* at 765. Thus, when acting as a discretionary investment manager for its fiduciary clients, JPMorgan retained knowledge of its conduct as repo financier and was obligated to take all necessary steps to protect the Class, including disclosure of its conflicted position and its conclusion that Sigma would fail. Because the undisputed facts establish that JPMorgan took no such steps, it breached its duty of loyalty as a matter of law.

2. JPMorgan's "Chinese Wall" Argument is Irrelevant and Inapplicable

JPMorgan also argues that it cannot be liable due to the purported "Chinese wall" between its fiduciary and commercial businesses. (*See* JPM Mem. at 17-20.) This argument is without merit.

First, JPMorgan's "Chinese wall" is in no way implicated in this case because the only information necessary for knowledge of the conflict – *i.e.*, JPMorgan's status as repo financier of Sigma and its conclusion that Sigma would likely fail – was *not* material non-public information. JPMorgan's own expert, Christopher Laursen, acknowledged that JPMorgan's status as repo financier was not material non-public information. *See* Ex. 23 (Laursen Tr. at 159-60). And Kodweis testified that neither he nor his team relied upon any non-public material information in reaching the conclusion in August 2007 that Sigma would likely fail. Ex. 3 (Kodweis Tr. at 140, 164-65). Because none of the necessary information constituted material non-public information, the wall is wholly irrelevant.[15]

Second, the wall is inapplicable because the party with the fiduciary disclosure obligation was *JPMorgan* – not simply one of its business lines or a limited number of employees.[16] JPMorgan was aware of its conflicted status and thus was obligated to disclose the conflict to the Class regardless of what internal barriers it chose to establish between business lines. Notably, courts have rejected the view that a fiduciary party can rely upon an internal "Chinese wall" to excuse the obligation to disclose material information to its beneficiaries – particularly where, as here, the information withheld is not material non-public information.

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[15] Laursen's testimony that JPMorgan's status as repo financier *may* have nonetheless been subject to a "need-to-know" restriction (*see id.* at 160-61) is off base given the need of securities lending and the Class to be fully informed of all actual or potential conflicts of interest. At most, any question over the "need" to know would be an issue for the trier of fact.

[16] The agreements with the Class identify the fiduciary as *JPMorgan*. *See* AFTRA SLA, attached to AFTRA's Amended Complaint ("Am. Compl.") as Exhibit A, ¶ 4(d).

For instance, in *Fischer v. Phila. Elec. Co.*, 994 F.2d 130, 135 (3d Cir. 1993), the defendant argued that its benefit counselors had not affirmatively misled plan participants about upcoming plan changes because the company had never told the counselors it was considering an early retirement plan in the first instance. In summarily rejected that argument, the Court held that ERISA's disclosure obligations cannot be so easily sidestepped:

> This explanation will not do, for the fiduciary obligations owed to the plan participants were owed by PECo as plan administrator. These obligations cannot be circumvented by building a "Chinese wall" around those employees on whom plan participants reasonably rely for important information and guidance about retirement.

Id. at 135. The result is the same here. JPMorgan was the fiduciary and knew of its conflicted status. It cannot avail itself of a "Chinese wall" defense to justify its non-disclosure of material information, particularly since it had the ability to disseminate the necessary information to the Class without disclosing material non-public information. JPMorgan's failure to do so is a clear breach of its duty.

Of course, had it conducted *any* analysis of the conflict prior to extending repo financing to Sigma, JPMorgan might have realized that such disclosures were necessary and could be made without transmitting protected information. Instead, no conflicts committee considered the issue; no risk management group analyzed the situation; no legal advice was sought; no informed consent of the beneficiaries was sought or obtained.[17] As Andrew Cox, JPMorgan's corporate designee, aptly summarized when asked to describe the conflict analysis JPMorgan undertook

[17] This lack of analysis itself constitutes a breach of fiduciary duty. When the potential for a conflict of interest arises, a fiduciary is required either "to step aside in favor of a neutral referee, or *at the least*, to conduct an *explicit inquiry* into the potential for a conflict of interest." *McMahon v. McDowell*, 794 F.2d 100, 110 (3d Cir. 1986) (emphasis added). *See also Bierwirth*, 680 F.2d at 276 (noting that defendants may have been required to resign given their conflicted status but "at the least ... were bound to take every feasible precaution to see that they had carefully considered the other side").

prior to extending repo to Sigma: "We did none." Ex. 17 (Cox Tr. at 88).

Finally, even if JPMorgan could properly raise a "Chinese wall" defense, the evidence establishes that personnel on both sides – and on top – of the wall were aware of the conflict and, thus, knew of the need for disclosure to the Class. Securities lending personnel had reason to believe that JPMorgan was a repo financier of Sigma (*see* Ex. 24 (O'Connor Tr. at 42-43; Wilson Tr. at 265-68; Shin Tr. at 185)) and, as set forth above, high-ranking officials of the investment bank had actual knowledge of conflict prior to extending repo financing to Sigma. Dimon and other "wall-straddlers" were equally aware of what was happening in both business lines. Given such facts, the wall is wholly irrelevant to JPMorgan's disclosure obligation or, at worst, would create genuine issues of material fact precluding summary judgment in JPMorgan's favor.

Under both New York law and ERISA, JPMorgan had a fiduciary obligation to disclose material information in its possession to the Class to allow them the opportunity to protect their financial interests. Because it is undisputed that JPMorgan breached its duty to disclose material information to the Class, plaintiffs are entitled to judgment as a matter of law on their duty of loyalty claim.

B. JPMorgan Breached Its Fiduciary Duties By Placing its Own Interests Ahead of the Interests of its Fiduciary Clients

In addition to its complete lack of disclosure, JPMorgan breached its fiduciary duty of loyalty by intentionally seeking to profit for itself knowing that its actions would materially impair the financial interests of the Class.

It is black letter law that a fiduciary "is strictly prohibited from engaging in transactions that … involve or create a conflict between the trustee's fiduciary duties and personal interests." RESTATEMENT (THIRD) OF TRUSTS § 78(2). Among other things, the rule "prohibits the trustee personally from engaging in transactions that, though not involving trust property, place the

trustee in a position in which it is reasonably foreseeable that a conflict of fiduciary and personal interests *may* arise in the future." *Id.* at cmt. a. This language makes clear that an actual conflict of interest is not required; even a reasonably foreseeable *potential* for conflict is prohibited.

1. Decisions Under New York Law Support Plaintiffs' Position

Contrary to JPMorgan's arguments, the common law of trusts prohibits a fiduciary from engaging in disloyal conduct *even while acting in a non-fiduciary capacity.*[18] As comment e to Section 78 of RESTATEMENT (THIRD) OF TRUSTS makes clear:

> [T]he prohibition extends to (i) a trustee's *personal* transactions with third parties that would place the trustee in a position in which conflict-of-interest temptations foreseeably may arise in the future, as well as to (ii) a trustee's *fiduciary* transactions with third parties that create such a risk of future conflicts between the trustee's fiduciary and personal interests. Thus, for example, a trustee must not acquire, for the trustee's personal account, a lease or encumbrance held by another on trust property.

Id. at cmt e (italics in original; underlining added).

Here, JPMorgan effectively *created* a superior encumbrance on trust property by voluntarily becoming a repo financier of Sigma with a higher priority claim to Sigma's assets in order to capitalize on "profit opportunities" for itself. In doing so, it knew that: (i) the Class' MTNs were secured only by a floating first priority lien (Ex. 1); (ii) repo financiers took title to Sigma's assets and that, in the event of default, those assets would not be available to support the MTNs (Ex. 16); (iii) Sigma would not likely survive as a going concern (Exs. 7, 10); and (iv) by providing Sigma with repo financing and taking title to more than $9.3 billion of Sigma's best assets, it was significantly impairing the value of the MTNs it held for the Class. Notwithstanding such knowledge, JPMorgan secretly moved forward with the financing, making

[18] *See, e.g., Pegram*, 530 U.S. at 224 ("[T]he trustee at common law characteristically wears only his fiduciary hat when he takes action to affect a beneficiary, whereas the trustee under ERISA may wear different hats.").

billions of dollars for itself while wiping out the MTNs of the Class.

Appellate courts in New York have regularly found violations of the duty of loyalty on far less egregious facts. For instance, in the *Dabney* decision authored by Judge Learned Hand, the Second Circuit held that Chase National Bank breached the duty of loyalty by engaging in financial transactions with a bond issuer that benefitted the bank at the expense of the bank's beneficiaries. After acknowledging the "most fundamental" nature of the duty of loyalty, the court held that the bank's collection of a loan from the bond issuer constituted a breach of the duties it owed to its beneficiary bondholders:

> [T]he power to collect should have yielded to the duty of loyalty, for all powers are to be interpreted as conditional upon observance of that duty.... A trustee is not absolved from his duty to defer his own to his beneficiary's interest because times have gotten bad; that is precisely the occasion that most calls for exercise of forbearance.... Collection would manifestly result in the bank's preference and would indubitably be a breach of its duty as trustee ... *it was a breach because the trustee put itself in a position of advantage vis-à-vis its beneficiary.*

Id. at 671-73 (emphasis added).[19] *See also Dudley v. Mealey*, 147 F.2d 268, 272-73 (2d Cir. 1945) (trustee breached duty of loyalty by placing itself in a position to profit as creditor to the detriment of its beneficiaries); *City Bank Farmers Trust Co. v. Cannon*, 291 N.Y. 125, 131-32 (1943) (corporate trustee breached duty of loyalty by continuing to hold trust assets consisting of its own stock, even though stock had been purchased before bank became trustee, testator insisted that shares be retained, and no evidence of bad faith).

Like the situation in *Dabney*, JPMorgan knew of Sigma's precarious financial condition –

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[19] The Second Circuit also recognized that "[i]t is hornbook law that the beneficiary's remedies for a breach of trust are the recovery of any damages which may result, or of *any profit which the trustee may have gained.*" *Id.* at 673 (emphasis added). Further, because "it is always irrelevant how long after the breach the trustee's profit is realized," *id.*, all of the nearly $2 billion in profits that JPMorgan made are subject to disgorgement. *See* AFTRA Am. Compl. at 29.

indeed, it expected Sigma to fail – but nonetheless entered into repo transactions to benefit itself knowing that its conduct would materially impair the financial interests of its fiduciary clients. JPMorgan voluntarily, knowingly and intentionally placed itself "in a position of advantage vis-à-vis its beneficiar[ies]" in order to capitalize on what it described as "very big money making opportunities" arising from Sigma's default. As such, JPMorgan, like its corporate predecessor in *Dabney*, breached the duty of loyalty by furthering its own pecuniary interests at the expense of those parties it was duty-bound to protect.[20]

2. Plaintiffs' Position is also Consistent with ERISA

ERISA compels the same result. Although ERISA, unlike the common law, allows fiduciaries to wear different "hats," a fiduciary is not allowed to exploit that distinction to enrich itself at the expense of its beneficiaries. Nor may a breaching ERISA fiduciary escape liability for directly profiting at the expense of the beneficiaries through the simple expedient of claiming it was not acting in its fiduciary capacity at the time. Indeed, to allow such conduct would render "the highest [duties] known to the law" completely impotent.

While an ERISA fiduciary is not typically liable for conduct taken in a non-fiduciary capacity, the "two hat" doctrine does not authorize a fiduciary to do anything it wishes while wearing its non-fiduciary "hat," regardless of consequences to its beneficiaries. Instead, the "two hat" doctrine has a limiting principle: a fiduciary cannot act to directly profit itself at the expense of beneficiaries and then skirt its duties by simply claiming its actions were undertaken in a non-

[20] JPMorgan attempts to distinguish *Dabney* by arguing that, in that case, the "same personnel" were involved in making the relevant fiduciary and non-fiduciary decisions (JPM Mem. at 20). Contrary to its argument, however, nothing in the district court or appellate decisions suggests that the same individuals were involved in both transactions; instead, like here, it was *the bank*'s involvement in both activities that the Court found to be a breach of duty. In any event, the evidence here establishes that Dimon and other top officials had knowledge of the Class' investment in Sigma MTNs and were personally involved in the repo financing of Sigma; thus, this case falls squarely within the holding of *Dabney*, even as JPMorgan views it.

fiduciary capacity. Any contrary interpretation would turn ERISA's protections on their head by allowing savvy fiduciaries to enrich themselves from unsuspecting beneficiaries with impunity.

For these reasons, courts have rejected attempts by fiduciaries, like JPMorgan, to use the "two hat" doctrine offensively to excuse self-dealing conduct that has harmed beneficiaries. In *Johnson v. Couturier*, 572 F.3d 1067 (9th Cir. 2009), for instance, ESOP participants alleged that the defendant fiduciaries – who were also officers and directors of a closely held corporation – breached the duty of loyalty by paying themselves excessive salaries and thereby devaluing the corporation and ESOP. Defendants argued that they were not acting in a fiduciary capacity at the time of the salary decisions and, thus, could not be liable for any breach of duty. *Id.* at 1077. The court, however, rejected that argument, noting that to hold otherwise would be to eviscerate ERISA's prohibition against self-dealing:

> Where, as here, an ESOP fiduciary also serves as a corporate director or officer, imposing ERISA duties on business decisions from which that individual *could directly profit* does not to us seem an unworkable rule. To the contrary, our holding merely comports with congressional intent in establishing ERISA fiduciary duties as "the highest known to the law." *To hold otherwise would protect from ERISA liability obvious self-dealing*, as Plaintiffs allege occurred here, to the detriment of the plan beneficiaries.

Id. (emphasis added; internal citation omitted).

JPMorgan's arguments in this case are precisely the danger of which the *Johnson* court warns. Relying on inapplicable case law, JPMorgan argues that it cannot be liable for its predatory course of conduct – in which it made billions of dollars for itself while wiping out its beneficiaries' investment – because it purportedly was not wearing its fiduciary "hat" at the time. (*See* JPM Mem. at 10-17.) But JPMorgan *intentionally created* the conflict to "directly profit" from various repo transactions with Sigma knowing that its conduct would cause harm to the Class. JPMorgan cannot escape the legal consequences of its self-dealing simply by claiming it

was wearing a different "hat" at the time of the offending conduct.

JPMorgan is asking the Court for a truly extraordinary holding: namely, that as a matter of law, a diversified financial services firm has absolute impunity to knowingly and aggressively take steps that decimate the value of investments in which that same firm has placed its fiduciary clients so long as those doing the pillaging are from the senior management and "private" side of the business. Under this absolutist theory, even facts that go beyond those in dispute here would be protected: for example, where senior management and the "private" side of a firm actively sought to engineer the financial collapse of a company in which the "public" side had placed fiduciary client investments. JPMorgan's theory would render fiduciary obligations a virtual nullity by leaving any financial services firm free to draw small self-serving lines around a handful of "public" side employees, while freeing up the rest of the firm to actively undermine the interests of its clients. Nothing about ERISA authorizes – let alone compels – such a result.

3. JPMorgan Cites No Authority that Supports Dismissal of Plaintiffs' Duty of Loyalty Claim

Critically, none of the authorities on which JPMorgan relies actually supports the broad blanket of immunity it seeks in this matter. Contrary to its baseless characterization (JPM Mem. at 12), there is nothing "strikingly similar" about JPMorgan's conduct here and the situations addressed in *Friend v. Sanwa Bank Cal.*, 35 F.3d 466 (9th Cir. 1994), and *Erschick v. United Mo. Bank of Kansas City, N.A.*, 948 F.2d 660 (10th Cir. 1991). *Friend* and *Erschick* each dealt with financial institutions that had *pre-existing financing arrangements* with a plan sponsor that *later* became a plan trustee. *See* 35 F.3d at 468; 948 F.2d at 663. In each case, the secured financing of the plan sponsor *pre-dated* the trusteeship, the potential conflict was *known to all*

parties, and there was *no evidence of any harm* to the beneficiaries.[21] Because neither decision addressed a situation where a fiduciary knowingly and directly profited at the expense of its beneficiaries, *Friend* and *Erschick* are entirely inapposite.

None of JPMorgan's other authorities support the predatory conduct in which it engaged in this case.[22] Notably, the OCC regulations on which JPMorgan purports to rely do not supplant but in fact *require compliance with* New York law and ERISA. *See* 12 C.F.R. §§ 9.2(b) & 9.5. Moreover, the fact that OCC Handbooks and an inapplicable FDIC manual contemplate that a bank, under certain circumstances, may lend to an issuer of securities held in a fiduciary account (*see* JPM Mem. at 15-16) does not even remotely support the secretive course of predatory and disloyal conduct in which JPMorgan engaged in this case.

Finally, the "Chinese wall" between securities lending and commercial business lines provides no defense to JPMorgan's conduct in this case. Although an effectively implemented informational barrier may prevent certain types of conflicts (such as insider trading) from arising, it is well-established that a wall cannot prevent all conflicts of interest. *See, e.g.,* "The Chinese Wall and Conflict of Interest in Banks," 34 Bus. Law. 73, 100 (1978) (concluding that "fiduciary as creditor" conflict cannot be resolved by Chinese wall because information about bank's

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[21] Notably, the concurrence in *Friend* stressed the need for the bank trustee to disclose its conflicted status to the predecessor trustee in order to ensure that all parties had the information necessary to evaluate the situation. *See* 35 F.3d at 471.

[22] Most of the legal decisions on which JPMorgan relies are wholly irrelevant to this case. *See DeLuca v. Blue Cross Blue Shield of Mich.*, 628 F.3d 743 (6th Cir. 2010) (defendant was not acting in a fiduciary capacity when negotiating hospital reimbursement rates); *Brock v. Citizens Bank of Clovis*, 841 F.2d 344 (10th Cir. 1988) (challenged plan loans were not *per se* violations but not resolving whether conduct violated ERISA); *In re Estate of Rockefeller*, 843 N.Y.S.2d 732 (App. Div. 2007) (trustee was not required to relinquish pre-existing personal property rights in favor of trust). The only other cases involving financing by a trustee to an issuer of securities held in trust (neither of which applied New York law) did not involve allegations that self-dealing by the bank caused harm to beneficiaries. *See In re Lerch's Estate*, 159 A.2d 506 (Pa. 1960); *Braman v. Central Hanover Bank & Trust Co.*, 47 A.2d 10 (N.J. Ch. 1946).

creditor status would be available to those persons responsible for the bank's fiduciary activities) (cited favorably in *Metro. Life Ins. Co. v. Glenn*, 554 U.S. 105, 117 (2008)). Moreover, the evidence establishes that the individuals directing the repo financing activities – including Dimon and other top officials – were acutely aware of the conflict with the Class but chose to proceed without a conflicts analysis or advice of counsel. This is *not* an instance where two competing business lines, blind to the activities of the other, unknowingly took adverse positions to one another; instead, JPMorgan, with full knowledge of the conflict, embarked on a scheme to enrich itself at the expense of the Class. Under such circumstances, a "Chinese wall" provides no defense to its intentional and knowing breaches of duty.

JPMorgan expected Sigma to fail; it secretly engaged in predatory repo financing with substantial haircuts, taking title to more than $9.3 billion of Sigma's best assets; and it had actual knowledge that its conduct would detrimentally and materially impair the financial interests of the Class. Under such circumstances, JPMorgan breached the duty of loyalty it owed to the Class and plaintiffs are entitled to judgment as a matter of law.

C. Neither of JPMorgan's Remaining Arguments Has Merit

Finally, JPMorgan's two remaining arguments (*see* JPM Mem. at 20-25) are equally faulty and do not support summary judgment in its favor.

First, contrary to the overblown rhetoric of JPMorgan and the *amicus*, plaintiffs are not seeking to impose "radical and unprecedented restrictions" (JPM Mem. at 20-23) on the financial services industry. Plaintiffs seek nothing more than to hold JPMorgan to the stringent legal obligations it voluntarily undertook by agreeing to act as a fiduciary for the Class. As explained in their response to SIFMA's *amicus* brief, plaintiffs are not seeking a bright-line rule prohibiting a bank from ever extending any type of financing to an issuer where the bank is also holding

securities of that issuer for a fiduciary client; instead, a fiduciary bank is prohibited only from knowingly profiting for itself at the direct expense of its beneficiaries. Under the specific facts of this case, JPMorgan plainly failed to comply with the "highest [duties] known to law."

Second, JPMorgan's argument that plaintiffs cannot establish causation lacks merit. As set forth above, plaintiffs can establish a breach of fiduciary duty and a *prima facie* case of loss to the Class; as such, JPMorgan bears the burden of proving that its unlawful conduct did *not* cause the complained of damages. *See, e.g., N.Y. Teamsters Council Health & Hosp. Fund v. Estate of DePerno*, 18 F.3d 179, 182-83 (2d Cir. 1994). JPMorgan does not even attempt to meet its evidentiary burden. In any event, JPMorgan's conduct proximately caused the Class' loss in numerous ways, including: (1) by failing to disclose its conflicted status and its expectation that Sigma would fail, JPMorgan precluded the Class from taking actions to protect its financial interests (*see* Declarations of named plaintiffs, collectively attached as Ex. 25) and (2) by taking title to more than $9.3 billion of Sigma's best assets, JPMorgan left less quantity and quality assets to support the Class' MTNs, thereby materially impairing the value of the beneficiaries' assets for JPMorgan's own benefit. Under such circumstances, causation is easily established and JPMorgan's motion should be denied. *See, e.g., Cushing v. Morning Pride Mfg., L.L.C.*, 05-Civ-3612, 2008 WL 283772 at *13 (E.D.N.Y. Jan. 30, 2008) ("Where causation is disputed, summary judgment is not appropriate unless only one conclusion may be drawn from the established facts.").

IV. CONCLUSION

For the foregoing reasons, plaintiffs respectfully request that the Court deny JPMorgan's motion for summary judgment and find that JPMorgan is liable as a matter of law for breaching the duty of loyalty owed to the Class.

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Respectfully submitted,

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