

**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.

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.

Consolidated as
Civil Action No. 09-00686 (SAS) (DF)

ECF Case

**PLAINTIFFS' RESPONSE TO THE *AMICUS CURIAE* BRIEF OF THE
SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION**

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I. INTRODUCTION

The *amicus curiae* brief filed by the Securities Industry and Financial Markets Association (“SIFMA”) in support of JPMorgan’s motion for partial summary judgment is devoted entirely to refuting an argument that plaintiffs do not advance. Relying upon overblown rhetoric and sweeping generalizations that bear no relation to the actual facts of this case, SIFMA accuses plaintiffs of seeking “to rewrite the rules governing financial institutions” based upon a purportedly “novel” conflict of interest theory. (Amicus at 2, 7 n.12.) But plaintiffs’ allegations are neither novel nor carry industry-wide impact; SIFMA’s attempt to characterize them as such rings hollow. Contrary to SIFMA’s multitude of doomsday predictions, plaintiffs’ theory of liability, which simply applies well-established legal principles to the facts of this case, will have no appreciable effect on the securities industry at large.

First, SIFMA’s cries over the purportedly far reaching consequences of the Court’s decision in this matter are creatures of its own imagination. SIFMA’s entire premise is based upon the erroneous belief that plaintiffs seek to prohibit a financial institution from extending any type of credit to an entity where the securities of such entity are held by a fiduciary client of the financial institution. (*See id.* at 1.) Plaintiffs seek no such prohibition. Nor do plaintiffs contend that the mere extension of credit by a bank to a corporate customer whose securities are held by the bank’s fiduciary clients creates a conflict of interest; or that the simultaneous operation of commercial banking and trust services automatically creates inherent and irreconcilable conflicts. (*See id.* at 1-2.)

Plaintiffs equally do not seek “the disaggregation of commercial and investment banking functions from asset management” or expect the Court to “impose a [new] regulatory framework” on the financial industry. (*Id.* at 7.) Instead, plaintiffs simply ask the Court to apply

a well-established principle of law – that a fiduciary bank may not knowingly enrich itself at the direct expense of its beneficiaries – to the specific and unique facts of this case.

Second, applicable regulations already require banks like JPMorgan to identify and remedy potential conflicts of interest. Accordingly, SIFMA’s concern that the Court’s denial of JPMorgan’s motion would somehow diminish credit and capital formation, and reduce access to service and products for investment management clients, is unwarranted. Banks routinely evaluate and analyze competing business lines to determine potential conflicts of interests and implement appropriate procedures for avoiding or ameliorating such risks as part of existing operations. In any event, JPMorgan was well aware of the conflict of interest before engaging in its disloyal conduct. JPMorgan finds itself a defendant in this suit not because it lacked the necessary resources to identify and manage conflicts, or because it failed to identify that its fiduciary clients were large holders of Sigma paper, but because it knowingly chose to enrich itself at the expense of those fiduciary clients despite being fully aware of such information.

Third, even if SIFMA’s arguments were otherwise relevant, its inherently biased nature is readily apparent. SIFMA’s leadership is stacked with former JPMorgan employees and its brief, lacking objective commentary on relevant issues, merely parrots arguments JPMorgan already makes in its own supporting brief. SIFMA is clearly a “friend of JPMorgan” but its status as “friend of the court” appears on much shakier ground.

II. ARGUMENT

A. **SIFMA Grossly Mischaracterizes Plaintiffs’ Conflict of Interest Claim**

Contrary to the central predicate of SIFMA’s brief, plaintiffs do not seek to prohibit any financial institution from ever extending credit to an issuer of securities that the institution holds in the accounts of fiduciary clients. Nor do plaintiffs contend that any such extension of credit

would necessarily create an unlawful conflict of interest. Instead, plaintiffs ask the Court to recognize, under the *specific facts of this case*, that JPMorgan breached its duty of loyalty to the Class where – with full knowledge of the Class’ investments in Sigma medium-term notes (“MTNs”) and with the expectation that Sigma would fail – it engaged in predatory repo financing with substantial haircuts, took title to more than \$9.3 billion of Sigma’s best assets for itself, and had actual knowledge that its conduct would materially impair the value of the Class’ notes when Sigma ultimately failed.

The evidence of record – which SIFMA fails to address in any way – establishes that JPMorgan predicted Sigma’s collapse; engaged in predatory repo with substantial haircuts to “cherry-pick” the best assets in Sigma’s portfolio for itself; immediately depleted the quantity and quality of Sigma’s assets by taking title to assets in an amount that exceeded the financing it provided by nearly a billion dollars; and ultimately reaped nearly \$2 billion of profits for itself while leaving the Class’ notes virtually worthless:¹

- On August 23, 2007, less than three months after purchasing \$500 million of Sigma MTNs for the Class, John Kodweis, head of Short-Term Fixed Income Origination (an internal department that had originated Sigma’s MTN program for a decade), sent an email to high-ranking JPMorgan officials predicting the demise of the SIV sector, including Sigma, and recommending that JPMorgan establish a team to identify and capitalize on “profit opportunities” arising from such demise.
- Within a week of Kodweis’ email, Jamie Dimon, JPMorgan’s CEO, established a broad-based team to “analyze a potential unwind of SIVs scenario.” From the start, Dimon was interested in learning “the systemic risk of a complete unwind of all SIVs” and was specifically focused on obtaining Sigma’s high-quality assets.
- In September 2007, JPMorgan began considering whether to provide repurchase financing (“repo”) to Sigma. As part of its due diligence analysis, JPMorgan

¹ Plaintiffs will include a detailed statement of facts, along with copies of all supporting record evidence, in their merits brief to be filed on March 31, 2011. The Declaration of Peter H. LeVan, Jr. (“LeVan Decl.”) filed contemporaneously herewith attaches one exhibit that plaintiffs offer solely in response to arguments raised by SIFMA.

concluded, consistent with Kodweis' email, that Sigma would likely fail. Rather than this being an impediment, Sigma's expected failure made repo financing more attractive because it allowed JPMorgan to purchase high-quality assets in large blocks at deep discounts or, in JPMorgan's words, to capitalize on "very big money making opportunities ... as the market deteriorates."

- Given its expectation that Sigma would fail, JPMorgan carefully reviewed Sigma's assets and selected only those securities that it wished to be part of the repo financing arrangements.
- JPMorgan thereafter extended \$8.4 billion in repo financing to Sigma and, as a result of aggressive "haircuts," took title to more than \$9.3 billion of Sigma's best assets.² JPMorgan never disclosed its conflicted status or its expectation that Sigma would fail to the Class.
- Long before it first extended repo financing to Sigma, JPMorgan was well aware of the conflict with the Class that would result, including the fact that its actions would seriously impair the value of the Class' MTNs when Sigma failed. Dimon and other top officials had actual knowledge of the conflict but, rather than taking steps to protect the Class, chose to focus on maximizing the "profit opportunity" for JPMorgan presented by Sigma's financial troubles.
- On September 30, 2008, after Sigma failed to satisfy one of JPMorgan's margin calls, JPMorgan declared a default of all operative repo agreements with Sigma and Sigma entered 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 MTNs that it continued to hold for the Class are now worth less than six cents on the dollar.

As evident from these facts, this is not a case where one line of JPMorgan's business, unaware of and acting separate from another line, had unexpected consequences on JPMorgan's

² Notwithstanding SIFMA's repeated assertions to the contrary (*see* Amicus at 3, 6 n.9, 9 n.16), repo financing is *not* the functional equivalent of secured lending. *See, e.g., S.E.C. v. Drysdale Secs. Corp.*, 785 F.2d 38, 41 (2d Cir. 1986) (rejecting argument that repo financing is equivalent to secured lending and identifying critical distinctions between the arrangements). Among other differences, repo financing with substantial "haircuts" has decidedly more adverse consequences for noteholders of the repo borrower. In traditional secured lending, the borrower grants the lender a security interest in one or more assets in an amount equal to the financing provided. Under a secured financing scenario, noteholders of the borrower would generally not be impaired post-financing because the borrower merely exchanged a security interest for an equal amount of cash. In predatory repo transactions with substantial haircuts of the kind JPMorgan engaged in here, however, noteholders of the borrower can be substantially impaired. Not only does the repo lender take title to (rather than a security interest in) specific assets but it also takes title to *substantially more assets* than the amount of financing provided.

fiduciary clients. Instead, upper level management at JPMorgan – the so called “wall-straddlers” who are charged with ensuring that conflicts are identified and remedied – consciously disregarded the impact of JPMorgan’s acts on fiduciary clients in order to make billions of dollars for itself. One would hope that this is not the type of conduct SIFMA’s members would urge the Court to condone.³

B. Neither OCC Regulations nor ERISA Authorizes JPMorgan’s Unlawful Conduct in this Case

Contrary to SIFMA’s arguments, neither the regulations promulgated by the Office of the Comptroller of the Currency (“OCC”) nor ERISA authorizes JPMorgan’s predatory and disloyal conduct in this case. Additionally, JPMorgan’s “Chinese wall” policy is neither relevant nor applicable.

The OCC regulations on which SIFMA relies (*see* Amicus at 3-4) expressly require national banks such as JPMorgan to “adopt and follow written policies and procedures adequate to maintain its fiduciary activities *in compliance with applicable law*,” which is defined as “the law of a state or other jurisdiction governing a national bank’s fiduciary relationship [and] any applicable Federal law governing those relationships.” *See* 12 C.F.R. §§ 9.2(b) & 9.5 (emphasis added). Thus, the OCC regulations *require compliance* with ERISA and New York fiduciary law; they do not supersede or modify any of its stringent obligations. Additionally, nothing in the OCC regulations even remotely authorizes the secretive course of predatory and self-dealing

³ Although SIFMA contends that JPMorgan’s motive is irrelevant (*see* Amicus at 5 n.7), it is well-accepted that an improper or selfish motive may inform a court’s determination that a fiduciary breached its duty of loyalty owed to beneficiaries. *See, e.g., In re Beacon Assocs. Litig.*, --- F. Supp. 2d ---, 2010 WL 3895582, *31 (S.D.N.Y. 2010) (upholding breach of loyalty claim in light of fiduciary’s fraudulent intent); George Gleason Bogert, Amy Morris Hess, *Bogert Trusts And Trustees*, BOGERT § 543 (2010) (“If the fiduciary buys up for himself an adverse or competing interest in the same property in which his trust has an interest ... he fails to give proper attention to his duty of loyalty to the beneficiary and *seeks to insert a selfish motive* into his dealings with the trust.”) (emphasis added).

conduct in which JPMorgan engaged in this case. SIFMA's argument that OCC regulations allow a bank, under certain circumstances, to make a loan to a fiduciary client (*see* Amicus at 4)⁴ is beside the point and in no way supports the view that a bank is permitted to secretly enrich itself at the direct expense of the beneficiary through predatory repo, as JPMorgan did here.⁵

SIFMA also attempts to turn ERISA on its head by arguing that JPMorgan is immune from liability because it purportedly was not acting in a fiduciary capacity when extending repo financing to Sigma. (*See* Amicus at 4-5.) But fiduciary obligations cannot be so easily disregarded. Although an ERISA fiduciary, unlike a fiduciary at common law, is typically not liable for conduct taken in a non-fiduciary capacity, an ERISA fiduciary does not have *carte blanche* to do whatever it wishes in a non-fiduciary capacity regardless of the resultant consequences to its beneficiaries.

Instead, ERISA's "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 that its actions were undertaken in a non-fiduciary capacity. Recognizing this fact, courts have rejected attempts by fiduciaries, like JPMorgan, to use the "two hat" doctrine offensively to excuse self-dealing conduct that causes harm to beneficiaries. *See, e.g., Johnson v. Couturier,*

⁴ Critically, even in lending to a fiduciary client, the OCC regulations make clear that a bank must be "fair" to the beneficiary and act in accordance by applicable law – a point conspicuously omitted from SIFMA's brief. *See* 12 C.F.R. § 9.12(c).

⁵ SIFMA's reliance upon certain SEC regulations and a Federal Deposit Insurance Corporation examination manual (*see* Amicus at 4) is equally flawed. The SEC's efforts to thwart insider trading and tainted research reports have nothing to do with this case. Moreover, because JPMorgan is a national bank governed by the OCC rather than a state-chartered bank overseen by the FDIC, the FDIC Trust Examination Manual is inapplicable. In any event, the FDIC manual expressly acknowledges that compliance with industry practices is no defense to a breach of fiduciary duty claim: "[M]erely because it is an industry practice does not necessarily mean that a fiduciary duty, law or regulation has not been violated." *FDIC Trust Exam. Man.* § 8(E), http://www.fdic.gov/regulations/examinations/trustmanual/section_8/section_viii.html.

572 F.3d 1067, 1077 (9th Cir. 2009) (ESOP fiduciaries who were also corporate officers were acting in fiduciary capacity when setting their allegedly excessive salaries because “[t]o hold otherwise would protect from ERISA liability obvious self-dealing”).

Finally, the “Chinese wall” purportedly in place between JPMorgan’s fiduciary and commercial businesses does not excuse JPMorgan’s conduct in this case. The evidence clearly establishes that Dimon and other top officials who were directing the repo financing had actual knowledge of the conflict but nonetheless chose to proceed in order to poach more than \$9.3 billion of Sigma’s best assets for JPMorgan’s own benefit. In addition, the evidence shows that securities lending personnel had heard that JPMorgan was providing repo financing to Sigma and thus were or should have been aware of a potential conflict.⁶

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 an orchestrated scheme to enrich itself at the expense of its beneficiaries. Under such circumstances, JPMorgan’s “Chinese wall” policy provides no defense to its unlawful conduct.

C. The Court’s Denial of JPMorgan’s Motion for Partial Summary Judgment Will Not Disrupt the Banking and Securities Industries

Continuing with its overstated rhetoric, SIFMA argues that plaintiffs’ theory “would substantially increase costs across virtually all financial services transactions and restrict the availability of products and services which provide essential liquidity and market efficiency.” (See Amicus at 8.) But OCC regulations already require national banks exercising fiduciary

⁶ On a related note, the “Chinese wall” defense does not save JPMorgan from its clear disclosure obligations, particularly given that information concerning JPMorgan’s status as repo financier and its conclusion that Sigma would likely fail was not protected from disclosure to its fiduciary clients. Plaintiffs will address this issue in their merits brief to be filed on March 31, 2011.

powers like JPMorgan to have systems in place to identify and prevent conflicts of interest. *See* 12 C.F.R. § 9.5(c) (requiring national banks to employ “methods for preventing self-dealing and conflicts of interest”). Accordingly, the Court’s denial of JPMorgan’s motion would not impose *any* new burdens on the financial industry.

Charles Grice, plaintiffs’ compliance expert, testified that numerous financial institutions already evaluate and analyze competing business lines to determine potential conflicts of interests and implement appropriate procedures for avoiding or ameliorating potential risks:

Every institution is doing this routinely on a variety of areas of risk. This is a risk focused, risk – we are trying – some banks call it a heat map. We are trying to look when you walk in our front door and contact us about a potential product or service, we understand what the potential outcome is from that conversation and we have to treat it appropriately. So we put the right controls around it.

LeVan Decl. at Ex. A (Grice Tr. at 152-53). Not every transaction needs to be fully vetted; banks “can segregate things that are more prone to conflicts from those that are much less prone to conflicts” so that the bank “can direct applicants for certain products and services to channels where they are automatically green-lighted because somebody in senior management has made a determination that that product presents very low probability for a conflict.” *Id.* at 150. While the precise method employed is left to each bank’s discretion, the fact remains that such a process is not only tenable but already in place in most financial institutions.

Moreover, SIFMA’s concern over the purported difficulty of identifying conflicts between numerous competing business lines (*see* Amicus at 6) is both misplaced and belied by the facts of this case. Here, JPMorgan was fully aware of the conflict with the Class long before embarking on its scheme to take more than \$9.3 billion of Sigma’s best assets for itself, knowing that its conduct would materially impair the MTNs it held for the Class. JPMorgan breached its duty of loyalty in this case not because it failed to appropriately identify a potential conflict of

interest but because it intentionally chose to ignore its knowledge of that conflict in order to enrich itself at the expense of its fiduciary clients.

D. SIFMA's Interest and Institutional Bias is Readily Apparent

Finally, SIFMA is far from a neutral observer seeking to offer its expertise to assist the Court in reaching a determination. Because it is closely allied with JPMorgan and merely restates arguments already advanced in JPMorgan's own papers (*compare* Amicus at 3-10 with JPM Mem. at 10-23), its brief should be disregarded. *See, e.g., Ryan v. Commodity Futures Trading Comm'n*, 125 F.3d 1062, 1063 (7th Cir. 1997) (*amicus* briefs filed by allies of litigants that duplicate arguments in litigant's brief should be disallowed) (Posner, J.).

As the security industry's primary lobbyist, SIFMA is "the main mouthpiece for the financial services industry" and "the biggest corporate player in national politics." Jeffrey H. Birnbaum, *Merger of Wall Street Groups Creates a Lobbying Powerhouse*, The Washington Post, Nov. 27, 2006, at D01. Beginning in June 2009, SIFMA reportedly launched the "execution phase" of a global campaign targeting policymakers and the media in an effort to counter what it saw as a "populist" backlash against bankers in the wake of the financial collapse. Robert Schmidt, *Wall Street Begins Campaign to Thwart 'Populist Overreaction'*, Bloomberg News, June 15, 2009. According to the Center for Responsive Politics, SIFMA has spent more than \$15 million in lobbying efforts over the last three years seeking to influence Congressional reforms in the wake of the financial crisis. *See*, Center for Responsive Politics, <http://www.opensecrets.org/lobby/clientsum.php?lname=Securities+Industry+%26+Financial+Mkt+Assn&year=2010> (last visited Mar.18, 2011).

Moreover, SIFMA's current President and Chief Executive Officer, T. Timothy Ryan, joined SIFMA after fifteen years of employment with JPMorgan. *See* Alexa Jaworski, *Sifma*

Names JPMorgan's Ryan CEO, Securities Technology Monitor, Jan. 17, 2008, <http://www.securitiestechologymonitor.com/news/21882-1.html> (last visited Mar.18, 2011). And in 2009, JPMorgan's head of global commodities, Blythe Masters, served as SIFMA's Chairman of the Board. See Robin Francis, SIFMA's Board of Directors and Newly Elected Officers Announced, <http://www.sifma.org/news/asp?id=8544> (last visited Mar.18, 2011).

SIFMA thus has very close ties to JPMorgan and its unsupported concerns and "straw man" arguments provide no meaningful input into any actual disputed issue in the case.

III. CONCLUSION

For the foregoing reasons, as well as those contained in plaintiffs' forthcoming merits brief (to be filed March 31, 2011), plaintiffs respectfully request that the Court deny JPMorgan's motion for partial summary judgment.

Dated: March 18, 2011

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this day a true and correct copy of Plaintiffs' Response to the *Amicus Curiae* Brief of the Securities Industry and Financial Markets Association and the Declaration of Peter H. LeVan, Jr. with one exhibit annexed thereto was served upon the following counsel by Notices of Electronic Case Filing generated by ECF.

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