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IN THE

Supreme Court of the United States

PATRICIA HOLTZ, ET AL.,

Petitioners,

v.

JPMORGAN CHASE BANK, N.A., ET AL.,

Respondents.

On Petition for a Writ of Certiorari
to the United States Court of Appeals
for the Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

The Securities Litigation Uniform Standards Act of 1998, prohibits state and federal courts from hearing class actions asserting state law claims if the plaintiffs are "alleging . . . a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1)(A). The courts of appeals are avowedly in conflict over the proper test for determining when a complaint qualifies as "alleging" such a "misrepresentation or omission" when the state law cause of action (*e.g.*, breach of contract or fiduciary duty) does not require such a misrepresentation or omission as an element of the claim. The Question Presented is:

When is a party properly held to be "alleging" a "misrepresentation or omission of a material fact" within the meaning of 15 U.S.C. § 78bb(f)(1)(A)?

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PETITION FOR A WRIT OF CERTIORARI

Petitioners Patricia Holtz, et al., respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit.

INTRODUCTION

The Securities Litigation Uniform Standards Act of 1998 (SLUSA), provides that "[n]o covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging . . . a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1)(A). Such claims must be brought either as individual actions or filed as federal securities class actions subject to the restrictions of the Private Securities Litigation Reform Act of 1995 (PSLRA), 15 U.S.C. §§ 77z-1, 78u-4.

SLUSA is easy enough to apply when plaintiffs bring state law fraud claims. But applying it to other kinds of claims – particularly to contract and breach of fiduciary claims – has bedeviled the courts of appeals, resulting in a multifaceted circuit conflict. On the one hand, a misrepresentation or omission is not a required element of a breach of contract or fiduciary duty cause of action. And, indeed, a great many contract and fiduciary duty claims have nothing to do with misrepresentations or omissions. For example, a defendant may breach its contract to provide real-time stock market information by simply failing to deliver the promised information. *See, e.g.*, *Green v. Ameritrade, Inc.*, 279 F.3d 590, 593-94 (8th

Cir. 2002). On the other hand, misrepresenting or omitting a material fact can sometimes form the basis of a breach of contract or fiduciary duty claim. So many traditional securities fraud claims may be pled as breach of contract or breach of fiduciary duty claims.

In addition, even when a contract or breach of fiduciary duty claim does not depend on allegations of fraud, plaintiffs may sometimes include allegations of dishonesty in their complaints as background or for atmospheric effect (thereby arguably "alleging" a misrepresentation in a very literal sense). But a plaintiff wanting to avoid SLUSA preemption might leave out express allegations of misrepresentations or omissions in a complaint that nonetheless is premised on assertions of fraud.

In light of these complexities, figuring out when a state law contract or fiduciary duty claim is barred by SLUSA has tied the courts of appeals in knots. As Judge Hamilton explained in another recent Seventh Circuit case, the "question has produced at least a three- or four-way circuit split." *Goldberg v. Bank of Am., N.A.*, 846 F.3d 913, 922 (7th Cir. 2017) (Hamilton, J., dissenting), *reh. denied* (Feb. 21, 2017); *see also, e.g.*, *Brown v. Calamos*, 664 F.3d 123, 127-29 (7th Cir. 2011) (Posner, J.) (surveying conflict); *Daniels v. Morgan Asset Mgmt., Inc.*, 497 Fed. Appx. 548, 553 (6th Cir. 2012) ("The circuits have split on the role an untrue statement or omission of material fact must play in the complaint in order to find SLUSA preclusion." (citation omitted)).

"Only the Supreme Court can settle this" conflict. *Goldberg*, 846 F.3d at 925 (Hamilton, J., dissenting). It should do so in this case.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-13a) is published at 846 F.3d 928. The opinion of the district court (Pet. App. 14a-25a) is unpublished, but available at 2013 WL 3240181.

JURISDICTION

The judgment of the court of appeals was entered on January 23, 2017. Pet. App. 1a. On April 16, 2017, Justice Kagan extended the time to file this petition through May 24, 2017. No. 16A979. On May 11, 2017, Justice Kagan further extended the time to file this petition through June 22, 2017. *Id.* This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

RELEVANT STATUTORY PROVISIONS

Section 78bb(f)(1) of Title 15 provides in relevant part:

> (1) **Class action limitations**
>
> No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging--
>
> > (A) a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security; or
> >
> > (B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.

STATEMENT OF THE CASE

I. Factual Background

Petitioners are individual investors who contracted with respondents (collectively "JPMorgan") to manage their investments. In exchange for management and advisory fees, JPMorgan promised to invest petitioners' money on the basis of independent, skilled investment analysis. Complaint ¶¶ 28-40.[1] In addition, because JPMorgan had undertaken a position of trust, it had a fiduciary obligation to act only in the interest of its clients, a duty it publicly recognized and incorporated into its contracts. *Id.* ¶¶ 21-27.

In choosing investments for their clients, petitioners' investment advisors could select funds managed by JPMorgan and its affiliates, or funds managed by unrelated entities. Putting clients into JPMorgan's proprietary funds was in JPMorgan's financial interest, but often not in the clients'. It was in JPMorgan's interest because in addition to collecting the fees it charged for the advisors' services, JPMorgan and its affiliates would charge fees for managing the investment funds. Clients, on the other hand, frequently would be better off invested in an outside fund, including because JPMorgan's funds often had much higher fees than their competitors'. *Id.* ¶¶42, 48, 70.

Recognizing this inherent conflict of interest, other major financial institutions, such as Morgan

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[1] The amended Complaint is reproduced at Pet. App. 26a-65a.

Stanley and Citigroup, refuse to invest clients' money in their own funds. *Id.* ¶ 43. Indeed, by 2011, the top ten largest fund companies had abandoned the practice, with the exception of JPMorgan. *Id.*

In the face of declining profits during the Great Recession, JPMorgan undertook a massive, centralized effort to push its individual investor clients into its own proprietary funds, whether those investments were in the best interest of the clients or not. *Id.* ¶¶ 41-48. As uncovered by the *New York Times*, JPMorgan established quotas and high bonuses for financial advisors who put clients into its proprietary funds. *Id.* ¶ 51. Under the company's compensation scheme, the vast majority of advisors' pay came as a result of such bonuses tied to the bank's interest rather than any measure of how successful the investments were for the clients. *Id.* ¶ 52. Advisors who put the most clients into proprietary funds were also singled out for internal recognition and praise, while those who continued to place their clients in unaffiliated funds were subject to enhanced supervision and even discipline. *Id.* ¶¶ 55-57, 60.

JPMorgan not only pressured advisors to put new clients into the bank's own funds but also pushed advisors to switch existing clients from non-affiliated funds to proprietary funds without considering whether the transactions costs (another source of revenue to JPMorgan) and other fees rendered the change a bad deal for the clients. *Id.* ¶¶ 69-74.

As a result of these policies and incentives, petitioners were not provided the independent investment research and analysis they paid for under

their contracts. Indeed, JPMorgan instructed its advisors that no research or analysis of its proprietary funds was necessary. *Id.* ¶¶ 54, 58. In the end, instead of having their investments managed solely for their own benefit, petitioners' interests were subordinated to JPMorgan's desire to prop up its profits.

II. Procedural Background

1. Petitioners filed this class action in federal court, asserting solely state law claims, including for breach of contract and fiduciary duties. Pet. App. 3a, 60a-63a. The district court dismissed the suit under SLUSA and the Seventh Circuit affirmed. *See* Pet. App. 3a, 13a.

Writing for the court, Judge Easterbrook acknowledged that the Complaint included no cause of action for fraud, misrepresentation, or omission of a material fact. Pet. App. 3a. Nor were the breach of contract and fiduciary duty claims founded on any allegation of misrepresentation or omission in any ordinary sense. *Id.* That is, the Complaint did not allege, for example, that JPMorgan breached its fiduciary duty by making a false statement to the class. Instead, the Complaint simply alleged that JPMorgan "failed to provide the independent research, financial advice, and due diligence required by the parties' contract and their fiduciary relationship." *Id.*

But the court of appeals nonetheless held that "nondisclosure is a linchpin of this suit" because if JPMorgan "had told customers that its investment advisors were compensated more for selling the Bank's mutual funds than for selling third-party

funds, plaintiffs would have no claim under either state or federal law." *Id.*

In making this assertion, the court did not claim that petitioner's causes of action would fail unless petitioners alleged such an omission.[2] Instead, it was sufficient that JPMorgan could defeat petitioners' claims by showing that it had disclosed the challenged practices at the outset of their relationship. *Id.* Not that the court claimed JPMorgan would (or could) actually defend the case on that ground. It was enough that the suit's ultimate success *theoretically* depended on the absence of such a disclosure. *Id.*

The Seventh Circuit seemingly recognized that this game could be played with respect to just about any contract or fiduciary duty claim, noting only two possible exceptions to its general preclusion rule: SLUSA would not apply if a defendant "broke its promise by mistake," Pet. App. 8a, or "if a decision to break the promise occurred after the promise had been made," *id.* 5a.

The court made little effort to square its rule with the language of the statute (which requires

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[2] *See, e.g.*, *Avila v. CitiMortgage, Inc.*, 801 F.3d 777, 786 (7th Cir. 2015) ("The elements of a claim for breach of contract are (1) the existence of a valid and enforceable contract; (2) substantial performance by the plaintiff; (3) breach of contract by the defendant; and (4) resultant injury to the plaintiff."); *Autotech Tech. Ltd. P'ship v. Automationdirect.com*, 471 F.3d 745, 748 (7th Cir. 2006) (elements of breach of fiduciary duty are "the existence of a fiduciary duty, breach of that duty, and damages proximately resulting from that breach").

actually "alleging" a misrepresentation or omission), focusing instead on its belief that sound policy required precluding petitioners' suit. *See* Pet. App. 5a-10a. In particular, the court focused at length on explaining why, in its view, petitioners' claims could have been brought as federal securities claims. *Id.*

2. The same day the decision in this case was announced, another Seventh Circuit panel with overlapping membership issued a divided decision in *Goldberg v. Bank of America, N.A.*, 846 F.3d 913 (2017). Applying the same rule, the *Goldberg* majority held the case before it was precluded by SLUSA because the contract and fiduciary duty claims "depend[ed] on the omission of a material fact," namely the defendant's intent to breach its contract and violate its fiduciary duties by keeping certain fees it should have transmitted to its customers. *Id.* at 915.

Judge Hamilton dissented. He observed that under "*Goldberg* and *Holtz*, now, virtually any breach of contract claim is preempted. If the defendant had told the plaintiff what it was actually doing, the plaintiff's acquiescence could have been treated as a modification or waiver of the relevant contract terms." *Id.* at 924 (Hamilton, J., dissenting). This, he noted, is not the law in other circuits. In fact, he explained, the "opinions in this case and *Holtz*[] widen an already existing circuit split under SLUSA," employing "logic that other circuits have rejected." *Id.* at 921. That conflict, he noted, could only be resolved by this Court. *Id.* at 925.

REASONS FOR GRANTING THE WRIT

The courts of appeals have divided three ways over the proper test for determining when a complaint should be seen as alleging a misrepresentation or material omission, so as to qualify for SLUSA preclusion. The conflict is intolerable and will not be resolved without this Court's intervention. At the same time, although the scope of SLUSA preclusion is a recurring question in the lower courts, opportunities for this Court to resolve the conflict will not arise nearly as often – if a district court concludes SLUSA is no bar, it will often remand the case to state court, a decision that cannot be appealed. *See Kircher v. Putnam Funds Trust*, 547 U.S. 633, 640-45 (2006). The Court should embrace this opportunity to put an end to the arbitrary treatment and forum shopping the circuit conflict necessarily fosters.

I. The Circuits Are Intractably Divided Over The Test For Deciding When A Party Is "Alleging A Misrepresentation Or Omission Of A Material Fact" Under SLUSA.

As Judge Hamilton noted in his *Goldberg* dissent, discerning whether a party has alleged a misrepresentation or material omission within the meaning of SLUSA "has produced at least a three- or four-way circuit split." *Goldberg v. Bank of Am., N.A.*, 846 F.3d 913, 922 (7th Cir. 2017) (Hamilton, J., dissenting).

A. The Majority Approach of the Second, Third, and Ninth Circuits.

The majority of circuits ask a straightforward question: whether "the plaintiffs can prevail on their claims without proving the defendants engaged in deceptive misrepresentations or omissions." *Id.* at 921 (citations omitted). If so, the suit is not precluded, even if it contains extraneous allegations of false statements or material omissions, and even if the plaintiff may have been able to draft a complaint that would have alleged securities fraud.

1. *Second Circuit*

In re Kingate Management Ltd. Litigation, 784 F.3d 128 (2d Cir. 2015), arose from the Bernie Madoff ponzi scheme. As relevant here, the class action complaint included allegations of breach of contractual and fiduciary duties. *Id.* at 135. In deciding whether those counts were barred by SLUSA, the court recognized that the statute's "broad, general terms are in some respects ambiguous, so that it is not always easy to understand whether SLUSA applies." *Id.* at 136. In particular, the statute's reference to parties "alleging" misrepresentation or material omission is "susceptible to" multiple "interpretations." *Id.* at 143.

First, "on the broadest of interpretations, 'alleging' could mean that SLUSA applies to any claim that includes any reference whatsoever to the false conduct specified in SLUSA, even if the false conduct is completely irrelevant to the state law theory of the defendant's liability." *Id.*

Second, the statute could preclude complaints "alleg[ing] conduct by the defendant" that amounts to

a misrepresentation or material omission "*and* that forms the basis for the defendant's state law liability." *Id.* at 144 (emphasis in original). In other words, when "the success of a class action claim depends on a showing that the defendant committed false conduct conforming to SLUSA's specifications, the claim will be subject to SLUSA, notwithstanding that the claim asserts liability . . . under a state law theory that does not include false conduct *as an essential element.*" *Id.* at 149 (emphasis in original).[3]

To the extent other courts might have adopted the first interpretation, the Second Circuit explained, "we respectfully disagree." *Id.* at 146. Instead, the court adopted the second interpretation. "In our view," the Second Circuit explained, "the history and the purposes of this provision all favor interpreting it to apply to state law claims predicated on conduct by the defendant that is specified in SLUSA's operative provisions." *Id.* (emphasis omitted).[4]

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[3] The court also noted a third possibility: SLUSA might apply even when the complaint alleges someone *other* than the defendant made a misrepresentation or omission, if that the misrepresentation or omission "must be proved in order for the state law claim" against the defendant "to succeed." *Id.* at 143. The distinction between misrepresentations made by the defendant and someone else does not arise in this case.

[4] New York's highest court has adopted the same interpretation. *See RGH Liquidating Trust v. Deloitte & Touche LLP*, 995 N.E.2d 329, 333-34 (NY 2011) (SLUSA bars suit when, "although not an essential element of the claim, the plaintiff alleges fraud as an integral part of the conduct giving rise to the claim") (citation omitted).

2. *Third Circuit*

In *Rowinski v. Salomon Smith Barney*, 398 F.3d 294 (3d Cir. 2005), the Third Circuit likewise held that where "allegations of a material mispresentation serve as the factual predicate of a state law claim, the misrepresentation prong is satisfied under SLUSA." *Id.* at 300. Under that standard, the court explained, it did not matter that misrepresentation "is not an essential legal element" of the claim; it is enough that to succeed in their particular claims, the plaintiffs must prove the misrepresentation. *Id.*

The Third Circuit reiterated this rule in *LaSala v. Bordier et Cie*, 519 F.3d 121 (3d Cir. 2008). SLUSA applies when a complaint includes "an allegation of a misrepresentation in connection with a securities trade" and that allegation "is a 'factual predicate' of the claim, even if misrepresentation is not a legal element of the claim." *Id.* at 141 (quoting *Rowinski*, 398 F.3d at 300). "Thus, when, as in *Rowinski*, a plaintiff alleges that a misrepresentation made in connection with a securities trade breaches a contract, the plaintiff cannot avoid SLUSA preemption by arguing that misrepresentation is not an element of a breach-of-contract action." *Id.*

However, the court held, SLUSA preemption does not apply simply because "a misrepresentation is alleged," if the allegation is unnecessary to the plaintiffs' state law claims. *Id.* The "inclusion of such extraneous allegations does not operate to require that the complaint must be dismissed under SLUSA." *Id.*

3. *Ninth Circuit*

The Ninth Circuit applies the same rule. In *Freeman Investments, L.P. v. Pacific Life Insurance Co.*, 704 F.3d 1110 (9th Cir. 2013), that court addressed whether "SLUSA displace[s] class actions alleging breach of a variable universal life insurance contract." *Id.* at 1113. Under those policies, the defendant insurance company invested a portion of the premiums on the customer's behalf, for which it was entitled to charge certain fees. The plaintiffs brought a breach of contract suit, alleging that the defendant had overcharged them. The Ninth Circuit held that although the insurance contracts qualified as covered securities under SLUSA, the breach-of-contract claims were not barred because they did not depend on allegations of misrepresentation or material omission. *Id.* at 1115.

Writing for the court, Judge Kozinsky agreed with "our sister circuits" that SLUSA "operates wherever deceptive statements or conduct form the gravamen or essence of the claim." *Id.* (citing *Rowinski*, 389 F.3d at 299-300). In the case before it, the court held, the breach of contract claim "alleges that Pacific charged them too much," in violation of their contract. SLUSA did not apply because in order to "succeed in this claim, plaintiffs need not show that Pacific misrepresented the cost of insurance or omitted critical details." *Id.*

The court specifically rejected any suggestion that SLUSA applied because the plaintiffs were, in effect, alleging that the defendant omitted to inform its clients how much it would be charging under its interpretation of the contract. *See id.* Although the defendant may have had a different understanding of

the contract from the outset, "that does not mean one party omitted a material fact by failing to anticipate, discover and disabuse the other of its contrary interpretation of a term of the contract." *Id.* (citation omitted). "Just as plaintiffs cannot avoid SLUSA through crafty pleading," the court cautioned, "defendants may not recast contract claims as fraud claims by arguing that they 'really' involve deception or misrepresentation." *Id.* at 1116.

B. The Sixth Circuit's Literalist Approach.

The Sixth Circuit takes an avowedly contrary, "literalist approach" that "authorizes a more expansive reading of SLUSA's reach than other circuits have adopted." *Daniels v. Morgan Asset Management, Inc.*, 497 Fed. Appx. 548, 553 (6th Cir. 2012) (citation omitted).

In *Segal v. Fifth Third Bank, N.A.*, 581 F.3d 305 (6th Cir. 2009), *reh. denied* (Dec. 16, 2009), the Sixth Circuit ruled that a complaint alleging breach of contract and fiduciary duty was barred by SLUSA because it included assertions that the defendants had "made misrepresentations" in connection with the sale of covered securities. *Id.* at 310. Judge Sutton's opinion acknowledged that the "state-law claims do not depend upon allegations of misrepresentation or manipulation – and thus are not material to them." *Id.* at 311. But that made no difference: the statute asks only "whether the complaint includes these types of allegations pure and simple." *Id.*

The court acknowledged the Third Circuit's decision in *LaSala*, which took the position that "the inclusion of . . . extraneous allegations [of

misrepresentation] does not operate to require that the complaint must be dismissed under SLUSA." *Segal*, 581 F.3d at 311-12 (quoting *LaSala*, 519 F.3d at 141). But the Sixth Circuit concluded that any such rule was inconsistent with the language of the statute, which, the court believed, should be given broad preclusive effect. *Id.*[5]

In subsequent cases, the Sixth Circuit has confirmed that it meant what it said in *Segal*. *See Atkinson v. Morgan Asset Management, Inc.*, 658 F.3d 549, 555 (6th Cir. 2011) ("Applying *Segal*, SLUSA precludes Plaintiffs' claims because they include allegations of misrepresentations and omissions, 'pure and simple.'" (citing 581 F.3d at 311)); *Daniels*, 497 Fed. Appx. at 553 ("[T]he literalist approach of our circuit makes it clear that the inquiry is only whether the complaint includes these types of allegations, not whether they are material elements of a claim." (citation omitted)).

That said, the Sixth Circuit applies the statute literally only when doing so bars a plaintiff's claim: any express reference to a misrepresentation results in preclusion, but failing to include an express

[5] The Sixth Circuit stated that *LaSala*'s treatment of extraneous allegations was dicta, inconsistent with *Rowinski*. *See Segal*, 581 F.3d at 312. But the discussion in *LaSala* was an alternative ground for reversal, not dicta. *See LaSala*, 519 F.3d at 140-41; *Mariana v. Fisher*, 338 F.3d 189, 201 (3d Cir. 2003) ("[A]n alternate holding has the same force as a single holding; it is binding precedent.") (citation omitted). Moreover, for the reasons *LaSala* explained, its explication of the Third Circuit's rule was completely consistent with the prior decision in *Rowinski*. *See LaSala*, 519 F.3d at 141.

reference will not avoid preclusion so long as the "substance of the complaint's allegations" involves misrepresentations or material omissions. *Segal*, 581 F.3d at 310-11.

C. The Seventh Circuit's Implied Omission Approach

The Seventh Circuit has rejected both the majority and the literalists approaches, adopting a position that effectively eliminates most contract and fiduciary duty claims, regardless of what the complaint actually alleges.

1. In *Brown v. Calamos*, 664 F.3d 123 (7th Cir. 2011), Judge Posner surveyed the then-existing conflict between the "literalist approach . . . taken by the Sixth Circuit" and the "contrary approach taken by the Third Circuit" (later to be joined by the Second and Ninth Circuits). *Id.* at 127.[6] The court rejected the literalist approach as adopting an impractical conception of what counts as an "allegation." *Id.* at 128. But it would not go so far as the Third Circuit and hold that SLUSA applied only when the state law claims depended on a factual allegation of misrepresentation or omission. Instead, the court held that a suit is barred by SLUSA whenever a court

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[6] He also reviewed what he called the "intermediate approach" of a non-precedential Ninth Circuit opinion, which he described as "tak[ing] off from the literalist approach" but "permitting the plaintiff to file an amended complaint that contains no allegation of a misrepresentation or misleading omission." *Id.* at 127. Since then, however, the Ninth Circuit has joined the majority position through its precedential opinion in *Freeman*, *see supra* § I.A.3.

concludes that a "misleading omission is . . . alleged, *at least implicitly*," *id.* at 127 (emphasis added), and it "is *likely* that an issue of fraud will arise in the course of the litigation." *Id.* at 128-29 (emphasis added).

In the case before the court, the plaintiffs alleged that managers of an investment fund violated their fiduciary duties by taking action that favored certain investment banks and brokers with whom the managers were in litigation, at the expense of other investors. *Id.* at 125-26. Judge Posner concluded that the complaint implicitly alleged misrepresentations and omissions regarding how the fund would be managed, *id.*, while nonetheless recognizing that those allegations were not material to the claims the plaintiffs actually made. *See id.* at 129 (explaining that the omitted "disclosures would be ineffectual against a claim of breach of the duty of loyalty because that duty is not dissolved by disclosure ('we are disloyal – *caveat emptor*!')").

Under the majority rule, that would have ended the SLUSA analysis, but Judge Posner carried on, launching into a detailed examination of the merits of the breach of loyalty claim. He concluded that the claims, as actually alleged, "might not be plausible." *Id.* at 130. Accordingly, he reasoned, to save their case, the plaintiffs might need to rely on the implied omission allegation. And because the "fraud allegations *may* be central to the case," the suit was "therefore barred by SLUSA under any reasonable standard." *Id.* (emphasis added).

2. The decisions in this case and *Goldberg* took the Seventh Circuit's already peculiar precedent one step further. *See Goldberg*, 846 F.3d at 924

(Hamilton, J., dissenting).[7] In both cases, the parties alleged very straight-forward breach of contract and fiduciary duty claims – here, alleging that the defendants did not provide the unbiased investment services required by contract and the defendants' fiduciary duties; in *Goldberg*, that the defendant charged more for its services than the contract allowed. In neither case were the plaintiffs required to establish a misrepresentation or omission in order to prove these claims. *See supra* p. 7 n.2. It was enough to show that the defendants did not provide the services promised under the terms agreed to.

Nonetheless, the Seventh Circuit held both actions barred because the plaintiffs would lose if the *defendants* demonstrated that they had disclosed at the outset the conduct giving rise to the plaintiffs' claims. Given the possibility of that hypothetical defense, the Seventh Circuit concluded that the complaints were "alleging . . . omission of a material fact," 15 U.S.C. § 78bb(f)(1)(A), even though nothing in the law of contracts or trusts required the plaintiffs to make or prove that allegation in order to prevail. Pet. App. 3a; *Goldberg*, 846 F.3d at 915.

3. The effect of these decisions is to subject all breach of contract and fiduciary duty claims to SLUSA preemption unless the breach occurs by mistake or the decision to breach arises after the client relationship is formed.

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[7] Judge Hamilton's reference to a "three- or four-way split" treats the Seventh Circuit as having adopted two conflicting approaches. *See Goldberg*, 846 F.3d at 922 (Hamilton, J., dissenting).

Judge Hamilton rightly observed that under "*Goldberg* and *Holtz*, now, virtually any breach of contract claim is preempted." *Goldberg*, 846 F.3d at 924. "If the defendant had told the plaintiff what it was actually doing, the plaintiff's acquiescence could have been treated as a modification or waiver of the relevant contract terms." *Id.* And under the Seventh Circuit's reasoning, whenever that is true, any breach of contract claim will be treated as impliedly alleging an omission – *i.e.*, that the defendant failed to disclose its plan to engage in the conduct that breached the contract. That leaves only breaches caused by mistake or a decision made after the contract was formed. Pet. App. 5a, 8a.

The Seventh Circuit was even more emphatic that its interpretation precluded all duty of loyalty claims, emphasizing its belief that there is no "nondisclosure or fiduciary-duty claim concerning investments in securities, traded in interstate commerce, that is outside the scope of federal securities law." *Id.* 10a.

4. The Seventh Circuit thus stands alone and in conflict with every other circuit to have considered the Question Presented. It expressly rejected the Sixth Circuit's literalist approach in *Brown*, 664 F.3d at 128. And its interpretation of SLUSA cannot be reconciled with the law in the Second, Third, and Ninth Circuits.

a. This case aptly illustrates the conflict. The Seventh Circuit did not contend that misrepresentation or omission is an element of a breach of contract or fiduciary duty claim. Under the majority rule, then, SLUSA could only apply if petitioners had nonetheless alleged a

misrepresentation or material omission as "a factual predicate of the claim[s]." *LaSala*, 519 F.3d at 141 (quoting *Rowinski*, 398 F.3d at 300). "To be a factual predicate [to a legal claim], the fact of a misrepresentation must be one that gives rise to liability, not merely an extraneous detail." *Id.* In this case, the Complaint contains no allegation of a misrepresentation that was material or essential to the success of petitioners' state law claims. Instead, petitioners straightforwardly allege that they contracted for independent, skilled research and investment advice, but did not get it. Complaint ¶¶ 88-89, 94. That failure breached the contract, plain and simple. No misrepresentation or omission needed to be proven. *See supra* p. 7 n.2.

Similarly, all petitioners had to prove to establish a breach of fiduciary duty claim was "the existence of a fiduciary duty, breach of that duty, and damages proximately resulting from that breach." *Autotech Tech. Ltd. P'ship v. Automationdirect.com*, 471 F.3d 745, 748 (7th Cir. 2006) (citation omitted). Here, they did that by alleging JPMorgan invested their savings into proprietary funds in furtherance of its own, rather than petitioners', best interests. Pet. App. 3a; Complaint ¶ 94. The claims thus turns on what respondents *did*, not anything they said or omitted.

The Seventh Circuit found an omission in this case only by moving beyond what petitioners alleged as "a 'factual predicate' of the claim," *LaSala*, 519 F.3d at 141 (quoting *Rowinski*, 398 F.3d at 300), and considering hypothetical defenses a defendant might raise (*i.e.*, full disclosure). That inquiry is not permitted under the majority rule and was explicitly

rejected by the Ninth Circuit in *Freeman*. In that case, Judge Kozinksi recognized that in every contract action it could be said that the defendant "omitted a material fact." 704 F.3d at 1115 (citation omitted). But he rejected the defendants' attempt to "recast contract claims as fraud claims by arguing that they 'really' involve deception or misrepresentation." *Id.*

b. The conflict is also laid bare by asking how cases in other circuits would have fared under the Seventh Circuit's rule. In *Freeman*, for example, the plaintiffs alleged the defendant breached its insurance contract by "levying excessive cost of insurance charges." *Id.* at 1114. In the Seventh Circuit, that claim would have been barred by SLUSA on the ground that if the defendant had disclosed what it planned to charge at the outset, the plaintiffs would have no contract claim. *See Goldberg*, 846 F.3d at 915 (plaintiffs' claims barred because they "depend[] on the omission of a material fact," namely that "the Bank kept [the] fees" not authorized by the fee schedule in the contract). But the Ninth Circuit allowed the claim to proceed.

Likewise, the Seventh Circuit's rule is irreconcilable with the Third Circuit's decision in *LaSala*. There, the court held that SLUSA did not preclude plaintiffs from pursuing claims against several Swiss banks under the Swiss-law equivalent of a breach of fiduciary duty standard. 519 F.3d at 140-41. Although the complaint alleged that the banks knowingly assisted their co-defendants in money-laundering scheme that involved multiple false statements, the Third Circuit held that those "prior alleged misrepresentations are not factual

predicates to these claims because . . . they have no bearing on whether the Banks' conduct is actionable" under the pleaded fiduciary duty theory. *Id.* at 141. The Seventh Circuit, on the other hand, would have held the claims barred under SLUSA because the defendants could have avoided liability by showing they had disclosed their planned conduct at the outset. *See* Pet. App. 3a.

D. The Circuit Conflict Is Entrenched And Will Not Be Resolved Without This Court's Intervention.

The conflict is long-standing and widely acknowledged. *See, e.g.*, *Goldberg*, 846 F.3d at 922-25 (Hamilton, J., dissenting) ("This question has produced at least a three- or four-way circuit split."); *id.* at 919-20 (Flaum, J., concurring) (describing split); *Brown*, 664 F.3d at 127 (Posner, J.) (same); *Daniels*, 497 Fed. Appx. at 553 ("The circuits have split on the role an untrue statement or omission of material fact must play in the complaint in order to find SLUSA preclusion."); 1 MCCLAUGHLIN ON CLASS ACTIONS § 2:44 (13th ed.) ("Courts have employed several rival approaches to evaluate whether a complaint's allegations trigger SLUSA preclusion."); 4 TREATISE ON THE LAW OF SECURITIES REGULATION § 12:44 (2017) (describing conflict); 1 PUBLICLY TRADED CORPORATIONS HANDBOOK § 7:42 (2017) ("The circuit courts are split 'on the role [of] an untrue statement or omission of material fact' . . . [in SLUSA preclusion analysis].") (citation omitted).

At present, the viability of breach of contract and fiduciary duty class actions involving securities depends entirely on where the lawsuit was filed.

That arbitrariness is itself intolerable, but it also creates an incentive for forum shopping, something SLUSA was enacted to prevent. *See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 82 (2006).

There is no prospect of the split resolving itself. The conflicting decisions acknowledge, but expressly disagree, with contrary precedent from other circuits. *See, e.g., Kingate*, 784 F.3d at 146 (Second Circuit expressly disagreeing with the Sixth Circuit's literalist approach); *Brown*, 664 F.3d at 127 (Posner, J.) (acknowledging, but disagreeing with other circuits' precedents); *Segal*, 581 F.3d at 312 (Sutton, J.) (Sixth Circuit expressly disagreeing with statement of law in Third Circuit's decision in *LaSala*). And the circuits have denied petitions for rehearing en banc in cases making up the split. *See, e.g., Goldberg*, 846 F.3d at 913, *reh. denied* (Feb. 21, 2017); *Segal*, 581 F.3d at 305, *reh. denied* (Dec. 16, 2009).

II. The Question Presented Is Recurring And Important.

Certiorari is also warranted because the scope of SLUSA's preclusive effect is a recurring and critically important question of federal law.

The breadth of the circuit conflict reflects the frequency with which the Question Presented arises in the lower courts. *See supra* § I; *see also, e.g., Rayner v. E*TRADE Fin. Corp.*, No. 16-CV-7129 (JGK), 2017 WL 1232730, at *3 (S.D.N.Y. Apr. 3, 2017); *Merryman v. J.P. Morgan Chase Bank, N.A.*, No. 15-CV-9188 (VEC), 2016 WL 5477776, at *6 (S.D.N.Y. Sept. 29, 2016); *Lewis v. Scottrade, Inc.*,

204 F. Supp. 3d 1064, 1068 (E.D. Mo. 2016); *Zola v. TD Ameritrade, Inc.*, 172 F. Supp. 3d 1055, 1072 (D. Neb. 2016), *appeal dismissed* (May 18, 2016); *Zweiman v. AXA Equitable Life Ins. Co.*, 146 F. Supp. 3d 536, 548 (S.D.N.Y. 2015); *Lerner v. TD Ameritrade, Inc.*, No. 8:14CV325, 2015 WL 12732467, at *3 (D. Neb. Aug. 20, 2015); *Knopick v. UBS Fin. Servs., Inc.*, 121 F. Supp. 3d 444, 455 (E.D. Pa. 2015); *Handal v. State St. Bank & Trust Co.*, 941 F. Supp. 2d 167, 184 (D. Mass. 2013).

Whether the Seventh Circuit's rule is correct is particularly important because it effectively precludes all relief for investors injured by breaches of contract or fiduciary obligations unaccompanied by bad faith or scienter. For example, investment advisors breach their contract whenever they fail to provide the services their customers contract for, whether they do so in bad faith or not. And they can breach their fiduciary duties through mere negligence. *See* RESTATEMENT (SECOND) OF TRUSTS § 170(2), 173 cmt. d. Yet, class actions alleging such violations will be barred by SLUSA under the Seventh Circuit's rule whenever the defendant could have avoided liability by disclosing its breaching conduct in advance. *See* Pet. App. 3a. While investors would be permitted to file individual state law claims, *id.* 12a, the cost of litigating such a case generally exceeds any potential recovery, making individual suits an illusory option. Investors would be permitted to file a federal securities class action instead, but the lack of scienter would doom that lawsuit to failure. *See* Pet. App. 10a.

The court of appeals' interpretation of SLUSA thus wipes out a significant body of long-standing

state law protection for investors even though federal securities law provides no substitute protection. Whether this was Congress's intent is an important question that should be decided by this Court.

III. This Case Presents An Ideal Vehicle For Resolving The Conflict.

The circuit conflict is squarely presented on the facts of this case, providing the Court an ideal opportunity to resolve the split.

As discussed, although dismissed under the Seventh Circuit's construction of SLUSA, petitioners' case would have survived under the majority rule of the Second, Third, and Ninth Circuits. *See supra* § I.C.4.

The case also squarely presents the conflict over the propriety of the Sixth Circuit's "literalist" approach. Respondents argued below that the Complaint contained numerous allegations of misrepresentations of the type the Sixth Circuit would hold sufficient to invoke SLUSA. *See* Resp. C.A. Br. 6-8 (pointing to allegations concerning defendants' public representations that they provided individualized advice based solely on client's interests) (citing, *e.g.*, Complaint ¶¶ 23-24, 26, 34-39); *Segal*, 581 F.3d at 311. As petitioners explained to the Seventh Circuit, those allegations were simply included to demonstrate that the *existence* of a fiduciary relationship was undisputed and that respondents had incorporated those common law duties into their contracts. *See* Petr. C.A. Reply Br. 4-8. They were not necessary to prove breach of contract or fiduciary duty. *See id.* But in the Sixth Circuit, allegations of misrepresentation trigger

SLUSA preclusion even if they are not "material" to the plaintiffs' causes of action. *Segal*, 581 F.3d at 311.

IV. The Decision Below Is Wrong.

The Seventh Circuit's decision particularly warrants review because it is so obviously wrong, casting aside the text of the statute in favor of what that court believes to be the most appropriate scope of SLUSA preclusion given its purposes.

1. SLUSA applies only when a plaintiff is "alleging" misrepresentations or omissions. *See* 15 U.S.C. § 78bb(f)(1)(A). The majority of circuits (including the Seventh Circuit) have rightly recognized that the word "alleging" refers to "charges of misconduct for which the plaintiff is seeking relief," *Brown*, 664 F.3d at 128, not every statement in a complaint. There is no reason to think Congress was concerned about the effects of *immaterial* allegations, particularly when a plaintiff could simply avoid preclusion by repleading.

At the same time, the majority of circuits have appropriately rejected the argument that SLUSA only applies when a plaintiff pursues a cause of action for which a misrepresentation or material omission is a necessary element. A party asserting fraudulent conduct to prove up any cause of action is properly seen as "alleging" a misrepresentation or omission because it is asserting that fact as a basis for relief. *See id.*

The Seventh Circuit departs from the majority approach and the text of the statute by contending that a plaintiff is implicitly "alleging" a misrepresentation or omission whenever a defendant

could hypothetically raise a disclosure defense that the plaintiff would have to controvert in order to prevail on the merits. Even if it were clear that the defendant could prevail on such a defense,[8] that prospect says nothing about what the plaintiffs are, in fact, "alleging." What a plaintiff is alleging turns on the allegations she has made, not on what a court supposes she may allege in the future.[9]

The Seventh Circuit's reasoning is all the more indefensible because it is far from inevitable that a defendant would raise a disclosure defense rather than, for example, denying it engaged in self-dealing. And if the defendant never claims to have made a disclosure, the plaintiff will never have occasion to allege an omission.

2. In the end, the Seventh Circuit's finding of "implied" allegations of omissions in cases like this one is simply a fudge to allow the court to implement its view of the proper scope of SLUSA preemption, which turns not on what the complaint alleges, but on whether the plaintiff *could have* brought claims

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[8] In fact, Judge Easterbrook's premise (Pet. App. 3a, 6a) that disclosure would have precluded petitioners' breach of fiduciary duty claim is wrong. *See Brown*, 664 F.3d at 129 (explaining that "disclosures would be ineffectual against a claim of breach of the duty of loyalty because that duty is not dissolved by disclosure") (collecting authorities).

[9] If a plaintiff amends her complaint, or seeks to prove up her complaint through allegations of fraud later in the case, the defendant is free to raise SLUSA preclusion at that time. *See* 15 U.S.C. § 78bb(f)(1) (providing that a no action "may be *maintained* in any State or Federal court" if it meets SLUSA's criteria) (emphasis added).

for federal securities fraud on the facts of the case. *See, e.g.*, Pet. App. 7a (explaining that contract claims barred by its rule are "a staple of federal securities law"); *id.* 10a ("Holtz has not pointed to any nondisclosure or fiduciary-duty claim concerning investments in securities, traded in interstate commerce, that is outside the scope of federal securities law."). In the Seventh Circuit's view, SLUSA would be "ineffectual" if plaintiffs with arguable federal securities fraud claims could pursue state law claims based on the same course of conduct without triggering preclusion. Pet. App. 4a-5a.

The problem is that the statute does not ask whether the plaintiff *could have* brought a federal securities fraud claim; it asks whether the plaintiff *did* allege a misrepresentation or material omission. In drafting the statute in that way, Congress unambiguously allowed plaintiffs to avoid SLUSA preclusion by declining to bring claims dependent on allegations of misrepresentation or material omissions.

The Seventh Circuit is wrong in thinking that applying the statute as written will fail to promote Congress's goal of preventing plaintiffs from avoiding the PSLRA by simply filing their securities fraud claims in state court. The majority rule faithfully implements the statutory language while also furthering that basic purpose by finding preclusion whenever liability is premised on the functional equivalent of the essential elements of a federal securities action (*i.e.*, a misrepresentation or material omission in connection with a securities sale).

The Seventh Circuit is not at liberty to "replace the actual text with speculation as to Congress'

intent." *Magwood v. Patterson*, 561 U.S. 320, 334 (2010). "Legislation is, after all, the art of compromise, the limitations expressed in statutory terms often the price of passage, and no statute yet known pursues its stated purpose at all costs." *Henson v. Santander Consumer USA Inc.*, No. 16-349, slip op. 9 (U.S. June 12, 2017) (internal punctuation and citation omitted).

Here, it is easy to understand why Congress elected not to enact the statute the Seventh Circuit believes it should have written. The Seventh Circuit's nebulous speculation about what issues are "likely" to arise in the case, how a defendant might respond to the allegations, or what other allegations the facts might have supported, is entirely unadministrable. *See Goldberg*, 846 F.3d at 927 (Hamilton, J., dissenting). Moreover, even when properly applied, SLUSA seriously invades State sovereignty, dictating to States how they must adjudicate state law claims in their own courts (*i.e.*, on an individual basis) in contravention of the State's own judgment about how best to protect its citizens and conserve its judicial resources. Accordingly, this Court has held that although SLUSA is not to be given a begrudging construction, its limits must also be respected out of deference to states' traditional role in enforcing common law obligations. *See Chadbourne & Parke LLP v. Troice*, 134 S. Ct. 1058, 1068-69 (2014); *see generally Merrill Lynch, Pierce, Fenner & Smith Inc. v. Manning*, 136 S. Ct. 1562, 1563 (2016).

Here, petitioners pursue the kinds of contract and fiduciary duty claims that fall in the heartland of traditional state authority that SLUSA, by its plain

terms, does nothing to displace. *See Goldberg*, 846 F.3d at 926 (Hamilton, J., dissenting).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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June 22, 2017

APPENDIX

APPENDIX A

In the
United States Court of Appeals
For the Seventh Circuit

No. 13-2609

PATRICIA HOLTZ, *et al.*,
Plaintiffs-Appellants,

v.

JPMORGAN CHASE BANK, N.A., *et al.*,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division. No. 12 C 7080 — **John W. Darrah**, *Judge*.

ARGUED APRIL 2, 2014 — DECIDED JANUARY 23, 2017

Before EASTERBROOK, MANION, and SYKES, *Circuit Judges*.

EASTERBROOK, *Circuit Judge*. JPMorgan Chase Bank offers to manage clients' portfolios of securities. Its affiliates sponsor mutual funds in which these funds can be placed. We refer to

JPMorgan Chase Bank and all of its affiliates collectively as "the Bank." According to the complaint in this case, customers invested in these mutual funds believing that, when recommending them as suitable vehicles, the Bank acts in clients' best interests (as its website proclaims). But Patricia Holtz, on behalf of a class of other investors, alleges that the Bank gives its employees incentives to place clients' money in the Bank's own mutual funds, even when those funds have higher fees or lower returns than competing funds sponsored by third parties. Holtz maintains that the Bank violated its promises and its fiduciary duties by inducing its investment advisers to make recommendations in the Bank's interest rather than the clients'.

Holtz filed this suit in federal court under the Class Action Fairness Act, 28 U.S.C. §1332(d)(2), because the class has more than 100 members, the stakes exceed $5 million, and at least one member of the class has citizenship different from the Bank's. This suit is also a "covered class action" for the purpose of the Securities Litigation Uniform Standards Act of 1998 (SLUSA or the Litigation Act), 15 U.S.C. §78bb(f), because mutual funds are securities. SLUSA requires the district court to dismiss any "covered class action" in which the plaintiff alleges "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security" (§78bb(f)(1)(A)). Under SLUSA, securities claims that depend on the nondisclosure of material facts must proceed under the federal securities laws exclusively. See, e.g., *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71

(2006); *In re Mutual Fund Market-- -Timing Litigation*, 468 F.3d 439 (7th Cir. 2006) (*Kircher IV*). Holtz does not want to invoke federal law and framed her claims entirely under state contract and fiduciary principles. But the district court concluded that these claims necessarily rest on the "omission of a material fact" and dismissed the suit under SLUSA. 2013 U.S. Dist. LEXIS 90066 (N.D. Ill. June 26, 2013).

Holtz maintains that falsehoods and omissions have nothing to do with her claims. She tells us that they "are not in any way based on, dependent upon, or necessarily entangled with proof that [the Bank] made any false statements or omitted to disclose material information. Rather, [she] assert[s] simply that [the Bank] failed to provide the independent research, financial advice, and due diligence required by the parties' contract and their fiduciary relationship." The district court's problem with this contention—our problem too—is that the suit depends on Holtz's assertion that the Bank concealed the incentives it gave its employees. If it had told customers that its investment advisors were compensated more for selling the Bank's mutual funds than for selling third-party funds, plaintiffs would have no claim under either state or federal law. This means that nondisclosure is a linchpin of this suit no matter how Holtz chose to frame the pleadings.

We grant that the complaint omits any allegation of *scienter*, which is essential in private securities-fraud litigation. See *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). Yet the Litigation

Act does not ask what state-law theory a plaintiff invokes. The statutory question is whether plaintiff alleges "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security" (§78bb(f)(1)(A)). Whether the complaint pleads a particular state of mind is neither here nor there—a point we made in *Brown v. Calamos*, 664 F.3d 123, 126–27 (7th Cir. 2011), when holding that an investor cannot avoid the Litigation Act by omitting an allegation of *scienter* and attempting to frame common-law claims under state law. Every other circuit that has addressed the question likewise has held that a plaintiff cannot sidestep SLUSA by omitting allegations of *scienter* or reliance. See *Miller v. Nationwide Life Insurance Co.*, 391 F.3d 698, 701–02 (5th Cir. 2004); *Atkinson v. Morgan Asset Management, Inc.*, 658 F.3d 549 (6th Cir. 2011); *Dudek v. Prudential Securities, Inc.*, 295 F.3d 875, 879–80 (8th Cir. 2002); *Anderson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 521 F.3d 1278, 1284 (10th Cir. 2008).

Dabit concluded that the Litigation Act is designed to prevent persons injured by securities transactions from engaging in artful pleading or forum shopping in order to evade limits on securities litigation that are designed to block frivolous or abusive suits. See 547 U.S. at 81–84. See also *Appert v. Morgan Stanley Dean Witter, Inc.*, 673 F.3d 609, 615 (7th Cir. 2012). Private class-action litigation about securities transactions must be conducted under federal securities law, so that limits adopted by Congress, or recognized by the Supreme Court, can be applied. Allowing plaintiffs to avoid the

Litigation Act by contending that they have "contract" claims about securities, rather than "securities" claims, would render the Litigation Act ineffectual, because almost all federal securities suits could be recharacterized as contract suits about the securities involved.

Federal law often permits genuine contract claims to survive preemption. So, for example, a contract requiring an investment manager to keep funds in an interest-bearing account pending the purchase of new securities could proceed under state law—if the manager by error failed to invest the money properly, or if a decision to break the promise occurred after the promise had been made and the money invested. (The significance of these qualifications will become clear later on.) But Holtz has not alleged that the Bank created the hidden conflict of interest only after she had invested her money.

The possibility that plain vanilla contract claims can proceed under state law creates an incentive to characterize all securities claims as "contract" suits and avoid federal preemption. Here's an example drawn from the Airline Deregulation Act, which preempts suits under state law that concern the price or quality of air service, see 49 U.S.C. §41713, but permits suits that rest on contracts. That sets up an opportunity for artful pleading. The plaintiff in *Northwest, Inc. v. Ginsberg*, 134 S. Ct. 1422 (2014), conceded that when excluding him from its frequent-flyer program the airline had followed the letter of its contract but contended that it had nonetheless not engaged in good faith and fair dealing. The Court

recognized that good faith and fair dealing is a longstanding doctrine of state contract law but held that it does not constitute a "contract" claim for the purpose of the Airline Deregulation Act. The Justices held that a claim "is pre-empted if it seeks to enlarge the contractual obligations that the parties voluntarily adopt." *Id.* at 1426. If the state-law duty is independent of the contract's terms, then it does not rest on contract.

Much the same can be said about Holtz's claims. She does not point to any explicit term that the Bank violated; instead she relies (as Ginsberg did) on a state-law duty to treat the other party fairly. That's what a fiduciary claim is all about. Indeed, Holtz contends that it is not even *possible* under state law to contract out of this duty—that is why Holtz submits that the Bank could not have reserved the right to favor its own interests over those of investors (at least not without explicit disclosure). Holtz uses this supposed non-negotiable fiduciary duty to show why, in her view, the suit does not depend on nondisclosure. But if the duty is non-negotiable, then under *Northwest* it is also non-contractual.

In *Dabit*, as in this case, the plaintiff tried to recharacterize as a state-law contract claim a situation that securities law sees as a nondisclosure claim. A mutual fund issued a prospectus asserting that the fund was operated in a way that held down transactions costs. Plaintiffs alleged that the fund broke this promise by secretly allowing some investors to make short-swing trades in order to take advantage of price differences between the closing

price in one nation and the price elsewhere, where stock exchanges closed at different times. Allowing short-swing trades not only increased transactions costs but also diverted wealth from long-term holders to the arbitrageurs. Plaintiffs maintained that they had contract claims, based on promises in the prospectus and other documents the fund had issued; the Supreme Court held, however, that because claims based on false statements in (or material omissions from) a prospectus are in connection with securities covered by federal law, it does not matter what state-law characterization might be possible. (*Kircher v. Putnam Funds Trust*, 403 F.3d 478 (7th Cir. 2005) (*Kircher I*), explains the nature of the claim in *Dabit* more fully than the Justices did. In *Dabit* the Supreme Court expressly agreed with this circuit, 547 U.S. at 74, 86, and rejected the contrary view of the Second Circuit—though later it vacated *Kircher I* after concluding that this court had lacked appellate jurisdiction. 547 U.S. 633 (2006) (*Kircher III*).)

The sort of situation we encounter—in which one party to a contract conceals the fact that it planned all along to favor its own interests—is a staple of federal securities law. When one side in *Wharf (Holdings) Ltd. v. United Int'l Holdings, Inc.*, 532 U.S. 588 (2001), contended that a suit alleging a broken promise was a simple contract claim, the Supreme Court replied that making a promise with intent not to keep it is fraud, and that when the subject of the contract is a security the claim involves securities fraud. The link to securities law is equally strong for Holtz's contention that the Bank promised

to recommend investments in her best interest, while intending all along to make recommendations in its own interest. We observed above that Holtz would have a contract claim free of a securities component if she alleged that the Bank broke its promise by mistake, or if the Bank created the incentive to favor its own mutual funds only after she had invested her money (which would take *Wharf* out of the picture). But she does not make either allegation.

A fiduciary that makes a securities trade without disclosing a conflict of interest violates federal securities law. See *In re E.F. Hutton & Co.*, 49 S.E.C. 829 (1988) (the several opinions in that decision collect many of the important decisions). Likewise a broker-dealer that fails to achieve best execution for a customer by arranging a trade whose terms favor the dealer rather than the client has a securities problem, not just a state-law contract or fiduciary-duty problem. See *Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 135 F.3d 266 (3d Cir. 1998) (en banc). A broker-dealer that churns securities (makes trades to generate commissions rather than extra value for the customer) likewise has a securities problem in addition to a state-law contract and fiduciary duty problem. See *Costello v. Oppenheimer & Co.*, 711 F.2d 1361 (7th Cir. 1983). Or consider *United States v. Naftalin*, 441 U.S. 768 (1979): a short seller assured the broker that he owned enough shares to deliver, but he did not and the sale therefore was a "naked short"; his lie was a breach of contract as well as fraud, and the Supreme Court held that it violated the Securities Act of 1934.

E.F. Hutton in particular shows that Holtz has a securities claim based on the Bank's (asserted) failure to disclose the conflict under which its employees were operating. Our decision in *Brown v. Calamos* reiterates the point. Plaintiffs alleged that managers of an investment fund pooled assets in a way that favored holders of preferred stock over holders of common stock. They presented this as a contract and fiduciary claim—which it was—but we thought that it was also a securities claim because it depended on nondisclosure of the procedures said to create the conflict. A statement along the lines of "we will act in your best interest" plus nondisclosure of a competing private interest is the basis of many securities actions. It is hard to see much difference between Holtz's theory and Brown's. After the Litigation Act, a plaintiff cannot proceed by omitting the securities theory and standing on state law in the sort of circumstances discussed in the preceding paragraph.

At oral argument, Holtz's lawyer told us that no sane person would have invested through the Bank had it revealed a bias for its own mutual funds—indeed, that the secret information contradicted the promise to act in investors' interest, and that the Bank never intended to keep its promise. All of this just brings the suit squarely within *Wharf*, which, recall, held that a concealed plan not to keep a promise about a securities transaction is securities fraud. Indeed, in *Brown* we rejected an argument that a plaintiff can avoid SLUSA by contending that no sane investor would have purchased the security (or the investment advice) if the truth had been told,

and that the suit therefore must be about substance rather than disclosure. 664 F.3d at 129.

Holtz has not pointed to any nondisclosure or fiduciary-duty claim concerning investments in securities, traded in interstate commerce, that is outside the scope of federal securities law. Sometimes a plaintiff will be unable to show a material lie or omission, intent to deceive, or the existence of a purchase or sale, and thus will not have a *winning* federal securities claim (even though he might have a good claim under state law), but *Dabit* holds that SLUSA applies whether or not a federal securities theory would succeed. Holtz's decision not to plead *scienter* means that she could not prevail under federal securities law, but as *Dabit* observes the Litigation Act would be ineffectual if it covered only winning securities claims. To protect defendants from weak or abusive claims of wrongdoing in connection with securities transactions, it is essential to block those that fail under federal law as well as those that could succeed.

Holtz has one more argument: that the Bank's omissions did not occur "in connection with" the purchase or sale of a covered security. The Litigation Act deals only with fraud or omissions in connection with covered securities. This branch of Holtz's argument rests on *Gavin v. AT&T Corp.*, 464 F.3d 634 (7th Cir. 2006), which holds that the Litigation Act does not block a suit concerning the terms on which shares of one company were exchanged for shares of another following a merger. AT&T acquired MediaOne in June 2000 and needed to issue new AT&T shares to persons who had held stock in

MediaOne. Communications offered those investors several options for conducting the exchange. Worried that investors who ignored these communications might find their investments subject to escheat, AT&T hired Georgeson Shareholder Communications six months after the merger closed and told Georgeson to do what it could to get investors to take the necessary steps. Georgeson sent letters that the plaintiffs later characterized as fraudulent for omitting the fact that, even long after the merger, people holding shares of MediaOne stock had one option that did not require payment of a fee for conducting the exchange.

As we saw matters in *Gavin*, the purchase or sale of securities was the merger in June 2000, not the ensuing swaps of certificates, so Georgeson's letter was not "in connection with" the sale of a covered security. *Gavin* does not assist Holtz, because the Bank's omission was made in connection with an impending investment decision (into which mutual fund would Holtz invest) rather than with a record-keeping decision. The Supreme Court held in *Dabit* that a decision *not* to sell a security (when influenced by a material misrepresentation or omission) is "in connection with" a purchase or sale of that security; the link between the secret fees to the Bank's employees and the choice of mutual funds is tighter than the link between the nondisclosure and non-sale in *Dabit*.

That some of the investment decisions were made by investment advisers as Holtz's agent does not take this out of the "in connection with" domain—otherwise suitability and churning could not be a

securities theory. *SEC v. Zandford*, 535 U.S. 813 (2002), holds that the "in connection with" requirement is satisfied when a broker makes a purchase or sale as an investor's agent. That's equally true of transactions that the Bank made as Holtz's agent.

The Litigation Act does allow state-law claims in which the misrepresentations or omissions are not "material," see *Appert*, 673 F.3d at 616–17, but Holtz has not argued that the Bank's incentives to its employees were too small to be "material" under the standard of *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27 (2011), and its predecessors. An omission is "material" when a reasonable investor would deem it significant to an investment decision. Holtz herself deems the Bank's incentives material to investments; that's the basis of this suit.

If she wants to pursue a contract or fiduciary-duty claim under state law, she has only to proceed in the usual way: one litigant against another. The Litigation Act is limited to "covered class actions," which means that Holtz could litigate for herself and as many as 49 other customers. 15 U.S.C. §78bb(f)(5)(B)(i)(I). What she can't do is litigate as representative of 50 or more other persons when the suit involves "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security". If the Bank did wrong by its customers, the SEC could file its own suit (or open an administrative proceeding) without regard to the Litigation Act—and the Commission sometimes can obtain relief without showing *scienter*. See *Aaron v. SEC*, 446 U.S. 680 (1980). What's more, states and

their subdivisions can litigate in state court; the Litigation Act exempts them. 15 U.S.C. §78bb(f)(3)(B). Thus there are plenty of ways to bring wrongdoers to account—but a class action that springs from lies or material omissions in connection with federally regulated securities is not among them.

AFFIRMED

APPENDIX B

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

PATRICIA HOLTZ, AUNT MARLENE FOUNDATION, and STEVEN GREENSPON, individually and on behalf of all others similarly situated,

Plaintiffs,

v.

J.P. MORGAN SECURITIES LLC;
JPMORGAN CHASE BANK, N.A.;
JPMORGAN CHASE & CO.; and
J.P. MORGAN INVESTMENT MANAGEMENT INC.,

Defendants.

Case No. 12-cv-7080
Judge John W. Darrah

MEMORANDUM OPINION AND ORDER

Plaintiffs Patricia Holtz, Aunt Marlene Foundation, and Steven Greenspon ("Plaintiffs"), individually and on behalf of all others similarly situated, have filed a class action complaint against Defendants, J.P. Morgan Securities LLC; JPMorgan Chase Bank, N.A.; JPMorgan Chase & Co.; and J.P. Morgan Investment Management Inc., asserting claims for breach of contract and good faith and fair

dealing (Count I), breach of fiduciary duty (Count II), and unjust enrichment (Count III). Defendants have filed a Motion to Dismiss Plaintiffs' Amended Complaint, pursuant to Federal Rules of Civil Procedure 12(b)(1) and 12(b)(6).

BACKGROUND

The following facts are drawn from Plaintiffs' Amended Complaint and are accepted as true for purposes of the Motion to Dismiss. *See Reger Dev., LLC v. Nat'l City Bank*, 592 F.3d 759, 763 (7th Cir. 2010). Plaintiffs purport to bring a class action on behalf of all financial advisory clients of Defendants, from January 1, 2008 through the present, whose assets were placed in Defendants' and/or their affiliates' proprietary mutual funds and who were charged investment management fees by Defendants. (Am. Compl. ¶ 1.)

According to Plaintiffs, Defendants pushed and incentivized their financial advisors to put Defendants' own financial interests ahead of those of their clients. (*Id.* ¶ 3.) In particular, Defendants required their financial advisors to strongly push and sell Defendants' own proprietary mutual funds and investments, as opposed to those funds and investments managed by third parties. (*Id.*) As a result of these practices, Defendants were able to substantially grow their assets and collect management fees, including the fees from JPMorgan-affiliated funds and investments themselves, as well as the fees from JPMorgan-affiliated entities that managed and provided services to the JPMorgan funds and investments. (*Id.*)

Defendants utilized a generous bonus structure to incentivize and pressure their financial advisors to steer or "switch" clients into JPMorgan proprietary funds and investments. (*Id.* ¶¶ 5, 7.) These switches were done for no other reason than to maximize revenues for Defendants' self-interested reasons and were contrary to client interests and not the result of research and analysis performed by the financial advisors. (*Id.* ¶ 7.) In contrast, financial advisors were not rewarded with high bonuses based on client performance or for placing clients in non-JPMorgan-sponsored investments. (*Id.* ¶ 7.)

Plaintiffs aver that Defendants breached contractual and fiduciary duties to act in their clients' best interests. Plaintiffs point to Defendants' statements about their fiduciary and contractual duties to clients that appear on JPMorgan's website and also in documents filed with the Securities and Exchange Commission (the "SEC"), as admissions by the Defendants regarding the nature of Defendants' obligations. Plaintiffs specifically disclaim that their allegations are not to be construed as allegations of fraud, misrepresentation or material omission. (*See* Am. Compl. ¶¶ 1, 23-26, 35-40; Pl.'s Resp. Br. at pp. 8-9.)

Defendants have moved to dismiss Plaintiffs' Amended Complaint for three reasons. First, Defendants contend that Plaintiffs' claims are covered by the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") and, therefore, subject to dismissal pursuant to Rule 12(b)(6). Second, Defendants contend that the Amended Complaint should be dismissed for failure to state a

claim under Rule 12(b)(6). Finally, Defendants argue that Plaintiffs' claims against Defendants JPMorgan Chase & Co. and J.P. Morgan Investment Management Inc. should be dismissed for lack of standing pursuant to Rule 12(b)(1).

LEGAL STANDARD

To properly assert a claim in a complaint, the plaintiff must present "a short and plain statement of the claim showing that the pleader is entitled to relief" and "a demand for the relief sought." Fed.R.Civ.P. 8. Rule 8 "does not require 'detailed factual allegations,' but it demands more than an unadorned, the-defendant-unlawfully-harmed-me accusation." *Ashcroft v. Iqbal*, 129 S.Ct. 1937, 1949 (2009) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007)). While a court is to accept all allegations contained in a complaint as true, this principle does not extend to legal conclusions. *Iqbal*, 129 S.Ct. at 1949.

The Federal Rules further permit a defendant to move to dismiss a claim if the plaintiff fails "to state a claim upon which relief can be granted." Fed.R.Civ.P. 12(b)(6). To defeat a motion to dismiss under Rule 12(b)(6), a plaintiff must plead sufficient factual matter to state a claim for relief that is "plausible on its face." *Iqbal*, 129 S.Ct. at 1949 (citing *Twombly*, 550 U.S. at 570). "While legal conclusions can provide the framework of a complaint, they must be supported by factual allegations." *Iqbal*, 129 S.Ct. at 1950. A threadbare statement of a claim supported by a conclusory statement is insufficient. *Iqbal*, 129 U.S. at 1949 (citing *Twombly,* 550 U.S. at 555).

Federal Rule 12(b)(1) also permits a defendant to move for dismissal of a claim where there is a lack of subject-matter jurisdiction, including whether the plaintiff has standing. *See Apex Digital, Inc. v. Sears, Roebuck & Co.*, 572 F.3d 440, 443 (7th Cir. 2009). As with motions to dismiss under Rule 12(b)(6), all material allegations of the complaint are accepted as true, and all reasonable inferences are drawn in favor of the plaintiff. *Retired Chicago Police Ass'n v. City of Chicago*, 76 F.3d 856, 862 (7th Cir. 1996). However, the plaintiff bears the burden of showing that it meets all the elements necessary for standing. *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 561 (1992).

ANALYSIS

Defendants' Motion to Dismiss Under SLUSA

SLUSA precludes a "covered class action" that is based on state law and that alleges "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security." *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 74 (2006) (quoting 15 U.S.C. § 78bb(f)(1)(A))). In *Dabit*, 547 U.S. at 86-87, the Supreme Court held that SLUSA's "in connection with the purchase or sale of securities" requirement should be construed broadly. A lawsuit precluded by SLUSA cannot be brought in state or federal court. *See Kircher v. Putnam Funds Trust*, 547 U.S. 633, 644 (2006). Under Seventh Circuit law, the proper remedy for a suit barred by SLUSA is dismissal with prejudice. *Brown v. Calamos*, 664 F.3d 123, 128 (7th Cir. 2011) ("[W]hen SLUSA is a bar, it operates as an

affirmative defense, which is a defense on the merits, not a jurisdictional defense.").

Defendants argue that Plaintiffs have alleged claims that are essentially fraud in connection with the sale and purchase of securities and that, as such, those claims are precluded by SLUSA. Plaintiffs seemingly do not dispute that their Amended Complaint asserts a "covered class action" under SLUSA, but unsurprisingly, strenuously object to the characterization of their claims as fraud. Plaintiffs make two arguments: (1) that the Amended Complaint asserts state law claims for breaches of contractual and fiduciary duties and does not allege misrepresentations or omissions of material fact to support a fraud claim; and (2) that the alleged wrongful acts were not done "in connection" with the purchase or sale of a security.

Material Misrepresentations or Omissions

When evaluating whether SLUSA applies, "the analysis must focus on the *substantive concepts* inherent in the complaint's allegations – not merely the words used." *Jorling v. Anthem, Inc.*, 836 F. Supp. 2d 821, 834 (S.D. Ind. 2011) (emphasis in original) (citing *Segal v. Fifth Third Bank, N.A.*, 581 F.3d 305 (6th Cir. 2009), and *Brown*, 664 F.3d at 128-29). SLUSA may not be eluded simply through "artful pleading" that omits words such as fraud or misrepresentation but still relies on those concepts. *Segal*, 581 F.3d at 311; *see also Brown*, 664 F.3d at 130; *Richek v. Bank of Am., N.A.*, No. 10-cv-6779, 2011 WL 3421512, at *3 (N.D. Ill. Aug. 4, 2011) ("when analyzing SLUSA preclusion, courts are

guided by substance rather than the form of a claim.") (internal citations and quotations omitted). Therefore, Plaintiffs' disclaimer of fraud alone is not sufficient to avoid SLUSA, and the underlying allegations must be evaluated as to whether SLUSA applies.

In *Brown*, 664 F.3d 123, the Seventh Circuit affirmed the dismissal under SLUSA of a class action complaint that alleged that company officials breached their fiduciary duties and were unjustly enriched when the company redeemed certain preferred stocks in a way that benefitted its investment banks and brokers to the detriment of its common shareholders. After surveying the standards used by the Sixth, Third and Ninth Circuits, the *Brown* court stated that a suit "is barred by SLUSA only if the allegations of the complaint make it likely that an issue of fraud will arise in the course of the litigation – as in this case." *Id.* at 128-29. The Seventh Circuit elaborated, holding that "the allegations of fraud would be difficult and maybe impossible to disentangle from the charge of breach of the duty of loyalty that the defendants owed their investors." *Id.* at 129.

In *Jorling*, 836 F. Supp. 2d 831, the class action plaintiff, a former mutual member of the defendant insurance company, alleged that the defendant failed to disclose key information during its demutualization process whereby plaintiff chose stock over cash in exchange for his ownership interests. The district court, following the standard articulated in *Brown*, held that SLUSA barred the plaintiff's complaint because it would be impossible to

"disentangle" the securities fraud issue from the plaintiff's state law claims involving fiduciary failure and breach of contract. *Id.* at 835. In so holding, the court further refused to elevate "form over substance" simply because plaintiff "carefully blotted out certain allegations" relating to fraud. *Id.*

The case of *Felton v. Morgan Stanley Dean Witter & Co.*, 429 F. Supp. 2d 684 (S.D.N.Y. 2006) is also instructive. In that case, the plaintiffs, investors with Morgan Stanley brokerage accounts, alleged that Morgan Stanley breached client agreements when it "failed to provide objective research and recommendations." *Id.* at 688. Morgan Stanley allegedly made biased recommendations based on its existing or desired investment banking deals, which benefitted Morgan Stanley. *Id.* at 693. The district court concluded, "without difficulty," that the plaintiffs' claim was a "securities fraud wolf dressed up in a breach of contract sheep's clothing." *Id.* The court thus rejected the plaintiffs' "artful pleading" and held that the claims were preempted by SLUSA. *Id.* at 694-95.[1]

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[1] Plaintiffs rely heavily on the S.D.N.Y district court case, *Norman v. Salomon Smith Barney, Inc.*, 350 F. Supp. 2d 382 (S.D.N.Y. 2004), in which the court held that the plaintiff investor's action against his investment advisor for breach of contract and fiduciary duty was not preempted by SLUSA. However, *Norman* is not persuasive for several reasons. It predates the Supreme Court's decision

Here, Plaintiffs have alleged that Defendants publicly represented that they were acting in their clients' best interests, when, in fact, Defendants were acting in their own self-interest to the detriment of their clients. Defendants stated on their websites that "our clients come first," "we work to understand our clients' needs [and] offer informed advice," and "[w]e will work closely with you to understand your unique needs and create solutions designed to help you meet your financial goals." (Am. Compl. ¶¶ 23, 24, 26.) Furthermore, Defendants, in documents filed with the SEC, stated that "JPMorgan funds are evaluated on the same criteria as unaffiliated funds." (Comp. ¶ 37.) However, according to Plaintiffs, Defendants did not perform these services. Instead, Defendants financially incentivized their financial

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Dabit, 547 U.S. at 86-87, in which the Supreme Court held that SLUSA's "in connection" requirement should be interpreted broadly. Furthermore, it predates the Seventh Circuit's decision in *Brown*, 664 F.3d at 129, which is controlling in this court. Likewise, it predates another S.D.N.Y. district court decision, *Felton*, 429 F. Supp. 2d 684, which had similar facts to *Norman* but nonetheless found that SLUSA precluded the plaintiffs' claims. Other courts have similarly distinguished Norman and found it unpersuasive. *See, e.g.*, *Dommert v. Raymond James Financial Servs.*, No. 1:06-CV-102, 2007 1018234 (E.D. Tex. Mar. 29, 2007); *Segal v. Fifth Third Bank*, N.A., No. 1:07-cv-348, 2008 WL 812990 (S.D. Ohio Mar. 25, 2008).

advisors to cease performing honest and competent account management services" and instructed their financial advisors "not to bother conducting the research and analysis necessary for client investments." Furthermore, Defendants encouraged their advisors "to sell this or that JPM proprietary fund above all else" and subjected them to "disciplinary action" if they failed to do so. (Am. Compl. ¶¶ 49, 54, 58, 60, 61.)

Although, as mentioned above, Plaintiffs attempt to limit the nature of these allegations to admissions by the Defendants regarding their obligations to Plaintiffs, the substance of Plaintiffs' allegations, when considered in their entirety, amounts to a claim of a fraudulent scheme by Defendants to sell Defendants' own proprietary mutual funds at the expense of their financial advisory clients. Plaintiffs' Amended Complaint is replete with allegations that Defendants misrepresented its services for its own financial gain. The allegations of Plaintiffs' Amended Complaint "make it likely that an issue of fraud will arise in the course of the litigation." *Brown*, 664 F.3d at 128-29. As in *Brown*, 664 F.3d at 129, and *Jorling*, 836 F. Supp. 2d at 835, it will "be difficult and maybe impossible to disentangle" the fraud from Plaintiffs' contractual and fiduciary duty claims. Consequently, despite Plaintiffs' artful pleading, the Amended Complaint presents a claim for fraud.

In Connection with Securities

Plaintiffs next argue that the alleged wrongful acts were not done "in connection" with the purchase or sale of a security. As mentioned above, the

Supreme Court announced in *Dabit*, 547 U.S. at 86-87, that SLUSA's "in connection with the purchase or sale of securities" requirement must be subjected to a broad construction. The Supreme Court explained that "it is enough that the fraud alleged 'coincide' with a securities transaction —whether by the plaintiff or by someone else." *Id.* at 86 (internal citations omitted).

The heart of Plaintiffs' Amended Complaint relates to the sale of Defendants' proprietary mutual funds, which hold securities. *See, e.g., Jones v. Harris Associates L.P.*, 130 S.Ct. 1418, 1422 (2010) ("A mutual fund is a pool of assets, consisting primarily of [a] portfolio [of] securities, and belonging to the individual investors holding shares in the fund.") (internal quotations and citations omitted). Indeed, Plaintiffs have defined their class brought on behalf of "all financial advisory clients of Defendants . . . whose funds were placed in Defendants' and/or their affiliates' proprietary mutual funds." (Am. Compl. ¶ 1.)

Although Plaintiffs rely on *Gavin v. AT&T Corp.*, 464 F.3d 634, 638 (7th Cir. 2006), that case does not support their argument. In *Gavin*, the Seventh Circuit held that the securities transaction, which took place months before the fraudulent omission, was not sufficiently related to the fraud so as to invoke SLUSA. *Id.* at 638-39. Unlike *Gavin*, here the alleged fraud directly relates to the sale of proprietary mutual funds and satisfies SLUSA's "in connection" requirement. *See Dabit*, 547 U.S. at 86-87.

Plaintiffs' Amended Complaint is preempted by SLUSA and, therefore, must be dismissed with prejudice. *See Brown*, 664 F.3d at 128.[2]

CONCLUSION

For the reasons set forth above, Defendants' Motion to Dismiss Plaintiffs' Amended Complaint [46] is granted. The Amended Complaint is dismissed with prejudice.

Date: June 26, 2013

/s/ John W. Darrah
JOHN W. DARRAH
United States
District Court Judge

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[2] Since SLUSA preempts the Amended Complaint, Defendants' other bases for dismissal do not need to be addressed.

APPENDIX C

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS

PATRICIA HOLTZ, AUNT MARLENE FOUNDATION, STEVEN GREENSPON, and TERENCE HEUEL, individually and on behalf of all others similarly situated, Plaintiffs, v. J.P. MORGAN SECURITIES LLC, JPMORGAN CHASE BANK, N.A., JPMORGAN CHASE & CO., and J.P. MORGAN INVESTMENT MANAGEMENT INC., Defendants.	**Case No. 12-CV-7080 (JWD)** **JURY TRIAL DEMANDED**

AMENDED CLASS ACTION COMPLAINT

Plaintiffs Patricia Holtz, Aunt Marlene Foundation, Steven Greenspon, and Terence Heuel (collectively, "Plaintiffs"), by and through their undersigned counsel, file this class action complaint

against defendants J.P. Morgan Securities LLC ("JPMS LLC"), JPMorgan Chase Bank, N.A. ("JPMC Bank"), JPMorgan Chase & Co. ("JPMorgan), and J.P. Morgan Investment Management Inc., (collectively, "Defendants"), individually and on behalf of all others similarly situated. The allegations in this Complaint are based upon personal knowledge as to matters concerning Plaintiffs and their own acts, and upon information and belief as to all other matters. The allegations that are not based on Plaintiffs' personal knowledge result from investigation by Plaintiffs' counsel. Plaintiffs believe that substantial additional evidential support will exist for the allegations set forth herein after a reasonable opportunity for discovery.

NATURE OF THE ACTION

1. This is a class action for breaches of fiduciary and contractual duties brought on behalf of all financial advisory clients of Defendants from January 1, 2008 through the present (the "Class Period") whose funds were placed in Defendants' and/or their affiliates' proprietary mutual funds and investments and who were charged investment management fees by Defendants in exchange for skilled, competent, and objective investment research and analysis, which Defendants failed to perform (the "Class"). This class action alleges claims for breach of fiduciary duty, breach of contract, breach of the implied covenant of good faith and fair dealing, and unjust enrichment. Plaintiffs do not allege fraud, deceptive practices, misrepresentation, or material omission in connection with the purchase or sale of securities.

2. Throughout the Class Period, Plaintiffs and other members of the Class entrusted their assets to Defendants and paid the Defendants investment management or advisory fees in exchange for investment advice and related services. Pursuant to this relationship, and in exchange for fees, the Defendants were obligated as fiduciaries and by contract to invest such assets in a responsible manner that would serve the best interests of their clients. The financial advisory services Defendants contracted to provide included providing objective research and analysis, analyzing and advising on alternative accounts and fee structures to maximize client returns, and providing investment management services. Performance of these services in the best interests of the client, with a duty of utmost loyalty, is at the heart of the financial advisor-client relationship.

3. In derogation of such duties and obligations, Defendants instead instituted centralized policies and practices designed to obliterate the fiduciary and contractual responsibilities owed to clients by pushing and incentivizing their financial advisors to put the financial interests of Defendants ahead of the financial interests of the clients. At the heart of such policies and practices was the decision – made at the most senior executive levels – to require Defendants' financial advisors to strongly push and sell their clients into own proprietary funds and investments, as opposed to those funds and investments managed by third parties. As a result of this decision, and the policies and practices that flowed from it, Defendants were able to substantially grow their assets under

management, while collecting not only the management fees that are the subject of this lawsuit, but also layers of additional fees collected by the JPMorgan-affiliated funds and investments themselves, and other JPMorgan-affiliated entities that managed and provided services to such JPMorgan funds and investments.

4. During the Class Period, at a time when its competitors were abandoning the practice of placing their clients into proprietary funds principally due to the severe conflicts of interests, Defendants hired hundreds of new financial advisors and pressured and incentivized them to sell proprietary JPMorgan funds and investments to as many clients as possible, regardless of whether or not it was in the clients' best interests to make such investments, and in breach of the duty of loyalty owed to the clients.

5. Because of Defendants' zeal to increase profits and market share, Defendants' financial advisors were awarded dramatically higher bonuses for steering clients into JPMorgan proprietary funds and investments. Financial advisors were not provided with such high bonuses based on client performance, nor were they provided with such bonuses for placing clients in non-JPMorgan-sponsored investments. These skewed incentives obliterated the duty of loyalty as Defendants' financial advisors ceased – at Defendants' directive – performing time-consuming research and analysis and were instructed to place as many clients as possible into as many of Defendants' proprietary funds and investments as possible, without regard for their clients' interests. Not surprisingly, the system worked well for Defendants,

as JPMorgan dramatically increased its market share and profits from this segment of its business over the course of the Class Period.

6. Defendants publicly admitted that their financial advisors owed fiduciary duties to their clients, including the duty to place their clients' financial interests ahead of their own. By utilizing a generous bonus structure that was designed to, and did, incentivize financial advisors not to perform the services owed by contract and as a fiduciary, and by otherwise pressuring financial advisors to forego any research or analysis of non-JPMorgan-sponsored funds and investments, the Defendants breached their contractual and fiduciary duties.

7. Defendants additionally incentivized and pressured their financial advisors to "switch" clients from non-proprietary mutual funds and investments to proprietary JPMorgan funds and investments to earn the fees associated with the switch. Mutual fund "switching" raises concerns regarding whether the financial advisor is acting in his client's best interests because of the fees associated with the switch. Acting in accordance with the centralized incentive practices and policies implemented by senior management, Defendants' financial advisors dispensed with the research and analysis necessary to justify a "switch" and moved their clients over to JPMorgan proprietary funds to generate fees that would be included in their bonus calculus. These switches were done for no other reason than to maximize revenues for Defendants' self-interested reasons and were contrary to client interests and not the result of research and analysis performed by the financial

advisors. The switching was little more than a quick way for financial advisors to collect the outsized bonuses promised by Defendants.

8. By putting their own financial interests ahead of the financial interests of Plaintiffs and the Class, and adopting centralized policies and practices to ensure that this would be so, Defendants breached their fiduciary duties and their contractual obligations to provide Plaintiffs and the Class with the skilled, objective, competent and honest financial advisory services for which they were paid. Since at least 2007, Defendants breached their duties to provide these services to their financial advisory clients and collected fees for services that they did not perform and that they did not earn. By this action, Plaintiffs and members of the Class seek to recover these management fees.

PARTIES

A. Plaintiffs

9. Plaintiff Patricia Holtz is a resident of Brookfield, Illinois. Plaintiff at all times relevant hereto contracted to receive financial advisory services from JPMS LLC (through its successor Chase Investment Services Corp. discussed below) and, as described below, was wrongfully subject to the conduct complained of herein.

10. Plaintiff Aunt Marlene Foundation is a resident of Chicago, Illinois. Plaintiff at all times relevant hereto contracted to receive investment management services from JPMC Bank and, as described below, was wrongfully subject to the conduct complained of herein.

11. Plaintiff Steven Greenspon is a resident of Lemont, Illinois. Plaintiff at all times relevant hereto contracted to receive investment management services from JPMC Bank and, as described below, was wrongfully subject to the conduct complained of herein.

12. Plaintiff Terence Heuel is a resident of Riverside, Illinois. Plaintiff at all times relevant hereto contracted to receive financial advisory services from JPMS LLC (through its successor Chase Investment Services Corp. discussed below) and, as described below, was wrongfully subject to the conduct complained of herein.

B. Defendants

13. Defendant J.P. Morgan Securities LLC ("JPMS LLC") is a Delaware limited liability corporation with a principal office at 383 Madison Avenue, New York, New York. JPMS LLC is a SEC-registered broker-dealer and investment advisor, and and member of the Financial Industry Regulatory Authority ("FINRA") with over 1,200 financial advisors. JPMS LLC is indirectly owned by JPMorgan, and under its control.

14. Defendant JPMS LLC is the successor by merger as of October 1, 2012 to Chase Investment Services Corp. ("CISC") which was initially named as a Defendant. CISC is a Delaware corporation with its principal executive offices located at 300 South Riverside Plaza, 7th Floor, Chicago, Illinois. Before the merger, CISC was at relevant times below an SEC-registered broker-dealer and investment advisor, and member of the Financial Industry

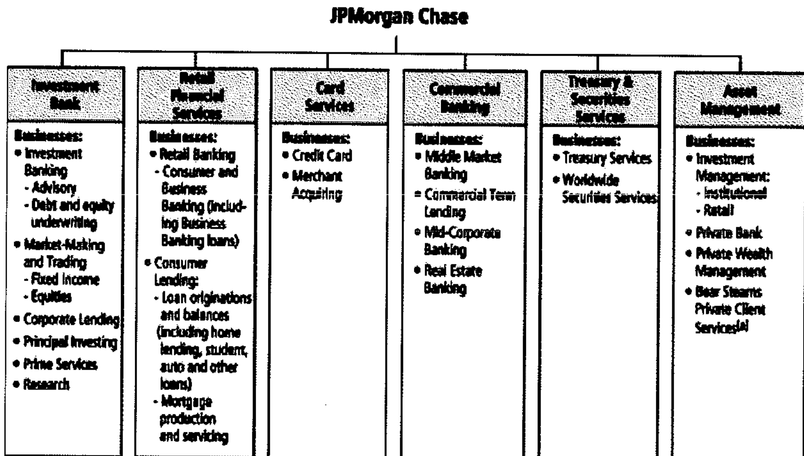
Regulatory Authority ("FINRA") with over 1,700 financial advisors. CISC was also indirectly owned by JPMorgan, and under its control.

15. Defendant JPMorgan Chase & Co. ("JPM") is a Delaware corporation with its principal executive offices located at 270 Park Avenue, New York, NY 10017. Shares of JPM trade on the New York Stock Exchange under ticker symbol "JPM." JPM is a leading global financial services firm with assets of $2.3 trillion and operations worldwide, and with $189.73 billion of shareholder equity as of March 31, 2012. The firm is a leader in investment banking, financial services for consumers and small businesses, commercial banking, financial transaction processing, asset management, and private equity. A component of the Dow Jones Industrial Average, JPM serves millions of consumers in the United States and many of the world's most prominent corporate, institutional and government clients under its JPMorgan and Chase brands.

16. Defendant J.P. Morgan Investment Management Inc., which is also known as JPMorgan Asset Management Holdings Inc., is a Delaware corporation with its principal executive offices located at 270 Park Avenue, New York, NY 10017. The company is a wholly owned subsidiary of Defendant JPMorgan Chase & Co. The company is an investment adviser registered under the Investment Company Act of 1940. It has over six hundred registered representatives servicing approximately sixteen hundred clients throughout the United States

and abroad, comprising over $700 billion in assets under management.

17. During relevant times, JPMorgan controlled JPMC Bank and JPMS LLC, through which Plaintiffs and their accounts were managed. On its annual Form 10-K reports, JPMorgan described "Asset Management" as one of its business segments, and provided the following chart reflecting its separate business lines:



<u>**See http://www.sec.gov/Archives/edgar/data/19617/000095012310016029/e82150e8215002.gif**</u>

18. In addition, JPMorgan, through its affiliates, controls also the proprietary funds and investment products offered by its subsidiaries which are the subject of this complaint.

JURISDICTION AND VENUE

19. This Court has original jurisdiction over the subject matter of this action pursuant to the Class Action Fairness Act ("CAFA"), 28 U.S.C. § 1332(d)(2), because at least one member of the class is a citizen of a state different from at least one defendant, the aggregate amount in controversy exceeds $5,000,000.00, and less than two-thirds of all Class members reside in the State of Illinois.

20. Venue is proper in this District pursuant to 28 U.S.C. § 1391(a), (b) and (c) because Defendants are located or conduct business in this District, a substantial part of the Defendants' conduct giving rise to the causes of actions occurred within this District, and the named plaintiffs reside in this district.

SUBSTANTIVE ALLEGATIONS

A. Defendants Owed Fiduciary Duties To Their Clients

21. JPMorgan, through its subsidiaries JPMS LLC and JPMC Bank, is one of the largest financial services companies in the world. Through its subsidiaries, JPMorgan offers private banking and wealth management services through investment accounts that are managed by its financial advisors and investment representatives. Through its subsidiaries, JPMorgan also offers several different managed account or wrap account programs that are available to investors. .

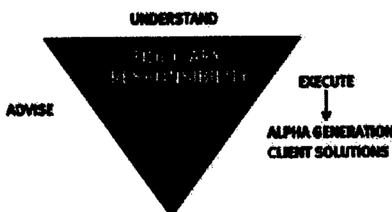
22. The financial advisors and representatives employed by both JPMC Bank and JPMS LLC were obligated to assist clients in managing their finances

or investments by providing objective guidance and advice regarding investments, estate planning, and retirement. These financial advisors also had the authority to make, and did make, investment decisions for their clients. Defendants publicly admitted (and admit) that their financial advisors owe(d) fiduciary duties to their clients, including the duty to place their clients' financial interests ahead of their own. Fiduciary duties also exist where, as here, clients have placed trust and confidence in a financial advisor to provide guidance or act in the clients' best interest. By virtue of their special relationship with their clients, financial advisors implicitly admit that there is an adequate basis for the opinions that he or she renders. Further, industry standards and customs require financial advisors to research and investigate securities before placing clients in investments. By virtue of this role, Defendants and the financial advisors they employed owed fiduciary duties of loyalty to their clients, including Plaintiffs and members of the Class. Consistent with these duties, the Defendants were obligated to act in the best interests of their clients, to the exclusion of all other interests and influences.

23. Defendants acknowledged and embraced the existence of a fiduciary relationship between them and their clients. Indeed, through the date of the filing of this Complaint, the website for JPMorgan's Asset Management Division contained the following description of the fiduciary duties owed to its clients:

Global Business Principles

Our Fiduciary Responsibility defines our relationship with our clients and informs every decision we take on their behalf. Our clients come first. We will not compromise their interests. These core principles form the foundation of our business — understanding our clients' needs, offering informed advice and executing to provide excess alpha performance and world class client solutions.



24. In addition, JPMorgan's website for its Asset Management Division described its Global Business Principle as follows:

> Throughout our long and distinguished history, we have been steadfastly committed to putting **our clients' interests first**.
>
> **This fiduciary relationship defines our relationship with clients and informs the basis of every decision we make on their behalf.** This core principle is the foundation of our business as we work to understand our clients' needs, offer informed advice, execute strategies to provide excess alpha performance and world-class client solutions. (Emphasis added.)

25. Moreover, the Private Banking division defined its mission on JPMorgan's website as follows:

> In everything we do, excellence and integrity are the guiding principles. ... **Integrity means keeping your interests front and center always**.... (Emphasis added.)

26. Before the merger, JPMS LLC held out on JPM's website that "[w]e will work closely with you to understand your unique needs and create solutions designed to help you meeting your financial goals."

27. Similarly, in discussing its relationship with clients, CISC provided on its website that "it is our responsibility to look at the world of investing through your eyes," and that its "investment products and services are tailored to enhance your complete financial situations." CISC also stated that its clients "will have access to over 900 individual funds from a wide selection of fund families."

B. In Addition To Their Fiduciary Duties, Defendants Had Separate Contractual Obligations To Their Clients Arising From Their Account Agreements

28. Defendants also owed contractual obligations to Plaintiffs and the other members of the Class pursuant to the standardized account agreements executed by and between Defendants and Plaintiffs and members of the Class. Under their financial advisory agreements, Defendants contracted to comply with all laws, rules, and regulations applicable to banks, brokerage firms, and investment advisors, as well as customs and standards in the financial services industry, representations made in marketing and advertising, and duties arising from common law.

29. Defendants were required to discharge their obligations under these agreements in a commercially reasonable manner and in accordance

with the covenant of good faith and fair dealing implied under every contract.

30. Indeed, Defendants agreed to act in the best interest of its clients and committed to "exercise discretion" and perform duties "consistent with applicable fiduciary standards."

31. In order to satisfy these financial advisory agreements, Defendants were, among other things, obligated to (i) conduct thorough and accurate research of investments and market conditions, and (ii) manage investments in the best interests of the client. In addition, Defendants were required to disregard their own economic interests where they conflicted with those of their clients.

32. As described in greater detail herein, Defendants failed to satisfy their contractual obligations under the financial advisory agreements and breached the implied covenant of good faith and fair dealing, resulting in economic harm to Plaintiffs and the other members of the Class. This economic harm was part and parcel of a strategy implemented and executed by Defendants, and their senior managers, which was designed to breach these contractual duties so that Defendants' economic interests were placed ahead of the interests of Defendants' clients.

C. Defendants' Managed Account Programs Had Uniform Duties To Account-Holders As Reflected In Brochures Filed On SEC ADV Forms

33. Defendants had several investment management or wrap fee account programs which

were offered to customers. Under each of these programs, depending upon how it is structured, JPMorgan will select a fund or investment manager for the customer, and monitor the fund or investment manager. The performance of these obligations of JPMorgan are at the core of the contractual and fiduciary duties owed to its customers which were corrupted as discussed below.

34. Upon information and belief, the customer account agreements for Defendants' "Managed Mutual Funds Portfolio" program, which is and was an advisory services program that selected and monitored mutual funds for its account-holders, contained the provision that "JPMorgan Funds undergo the same initial due diligence and ongoing monitoring that unaffiliated third party mutual funds in the Program undergo, and must meet the Program's same qualitative and quantitative criteria for inclusion."

35. Defendants also had managed account programs where the firm or its individual financial advisors make the investment management decisions for the account-holders. In a recent "Brochure" filed with the SEC as a schedule to Form ADV, Defendants provided the following description of the services provided under its programs:

> In formulating investment advice or managing assets in the Program, JPMS (through the Advisory Representatives) uses various methods of analysis, including:
>
> - fundamental analysis, typically an effort to measure the intrinsic

value of a security through analysis of the issuer itself, its financial statements and condition, its management and competitive advantages, and its competitors and markets;

- technical analysis, typically involving the study of data generated by market activity, such as past security prices and volume, in an effort to identify patterns and trends that may suggest a security's future price performance; and
- cyclical analysis, generally involving the examination of macroeconomic and market trends as a guide to forecasting security prices.

The method(s) of analysis used for purposes of the management of a client's Program account varies from Advisory Representative to Advisory Representative and depends on the individual practice and investing philosophy of the Advisory Representative.

36. This summary of the analysis performed by Defendants for its customers under this advisory program fairly reflects the duties assumed implicitly by any investment manager, who assumes management obligations for a fee. The SEC-filed "Brochure" for these managed account programs also provide that JPMorgan's advisors are "subject to

substantially the same selection and review processes and criteria," as other advisors.

37. In recent SEC-filed Brochures for other programs including the Chase Strategic Portfolio program, there is the same provision that JPMorgan funds are evaluated on the same criteria as unaffiliated funds.

38. The Brochure for Defendants' Chase Strategic Portfolio describes the program as follows:

> **A Customized Solution**
>
> **The Chase Strategic Portfolio is a fee-based investment advisory program that brings together world-class investment management capabilities, people and processes to deliver an innovative investment experience you won't find anywhere else.**
>
> In a Chase Strategic Portfolio, your investment will be:
>
> - **Broadly diversified** across multiple quity and fixed income asset classes to deliver an optimal portfolip of investments.
> - **Professionally managed** and blended among a variety of investments to enhance returns while reducing risk and dependency on a single Investment Manager's performance—a portfolio may include mutual funds, exchange traded funds,

separately managed accounts and money market funds.

- Carefull constructed for your **investment objective** and consolidated into one comprehensive account.

39. The Chase Strategic Portfolio also references these services provided to investors:

- "Together, you [and your financial advisor] will select from our 35 distinct investment portfolios to find one designed for your unique financial goals."
- "Chase Strategic Portfolios are constructed based on risk analyses and historical asset class returns."
- "All Investment Managers are selected by Chase Investment Services based on a rigorous screening process, which favors long-term, risk-adjusted performance."
- "Face-to-face meetings are conducted with every Investment Manager to look beyond the numbers."
- "[We] screen risk and return statistics from a wide range of Investment Managers"
- "[We] indentify Investment Managers with experience, a defined investment process and suitable risk management techniques."
- "Ongoing performance review and oversight of Investment Managers."

40. The services, duties and obligations reflected in these Brochures filed by Defendants as attachments to their SEC Form ADV evidence contractual duties owed to Plaintiff and the Class under their managed account programs. In particular, the provision applying the "same criteria" to JPMorgan funds was a fundamental obligation incorporated in some cases explicitly, and otherwise impliedly, into the account agreement.

D. In The Pursuit Of Greater Profits, Defendants Institute A Policy To Push Their Proprietary Funds And Investments On Clients

41. By late 2008, the United States was in the throes of what many economists consider the worst financial crisis since the Great Depression. Large banks, including JPM, were at the epicenter of this economic crisis.

42. In an attempt to recover from declining profits and to bolster JPM's diminished balance sheet, Defendants dedicated more resources to placing their financial advisory clients into Defendants' proprietary funds and investments with fee-based accounts that were not in their best interests. This new strategy allowed Defendants to collect account management fees from clients, as well as fees associated with the transfer of those investments into Defendants' proprietary funds and investments in many cases (*i.e.*, upfront fees).

43. Placing clients' money in proprietary funds and investments is a controversial practice that many companies, such as Morgan Stanley and

Citigroup, have abandoned because of the clear conflicts of interest that are implicated. By 2011, in fact, JPMorgan was the only bank among the 10 largest fund companies still engaging in this practice, according to the research firm *Strategic Insights*.

44. *The New York Times* has reported that the policies and practices implemented by Defendants to incentivize their financial advisors to act contrary to their fiduciary and contractual duties emanated from the very top of JPMorgan's senior management. According to *The New York Times*, which relied on two company executives who spoke to *The New York Times* anonymously, JPMorgan's chief executive officer ("CEO"), Jamie Dimon, at first balked at the idea of pushing JPMorgan's proprietary funds and investments on clients. However, Mr. Dimon relented after Jes Staley, then head of JPMorgan's Asset Management Division (and now head of JPMorgan's Investment Banking Division), successfully argued to him that the Company should ramp up its focus on steering clients into proprietary funds and investments in order to collect more fees and "earn" more profits.

45. Thus, while similarly situated institutions were cutting jobs, JPMorgan set out to grow its proprietary product management arm, adding hundreds of financial advisors to its employee roster. Since 2008, JPMorgan has added hundreds of financial advisors in its branches, bringing its total to roughly 3,100.

46. At the center of JPMorga's push are managed and fee-based accounts like the Chase Strategic

Portfolio ("CSP"), which JPMorgan heavily promoted in its bank and brokerage branches around the country. The CSP is a fee-based investment-advisory program that combines roughly 15 mutual funds, some developed by JPMorgan and some not. It is purportedly intended to offer ordinary investors holdings in stocks and bonds, with six main models that vary the level of risk.

47. In the press release announcing the launch of the CSP, JPMorgan reiterated its commitment to the fiduciary relationship it has with its clients, stating that "[a] financial advisor uses a client's individual goals, financial needs and risk tolerance to help determine an appropriate asset-allocation strategy, and then the best portfolio." JPMorgan, however, was unconcerned with conducting the research necessary to identify the "best portfolio" – choosing instead to use its own proprietary funds and investments to profit through the constant flow of account and management fees.

48. The CSP account product has been a boon for Defendants. In the four short years since its creation, this fund has amassed roughly $20 billion in assets, according to *The New York Times*. While an independent financial planner may charge a one-percent fee to manage assets for ordinary investors, JPMorgan charged an annual fee as high as 1.6 percent of assets to some customers in the CSP account. On top of this, JPMorgan collected upfront fees for steering clients from non-proprietary fund families into JPM-sponsored fund families, as well as collecting fees from the proprietary funds and investments themselves.

E. Defendants Adopted Policies To Incentivize And Pressure Their Employees to Place Clients In Defendants' Proprietary Funds And Investments To Maximize Profits

49. Defendants' bonus and incentive structure was at the heart of JPMorgan's centralized strategy to maximize profits. Defendants financially incentivized their financial advisors to cease performing honest and competent account management services for clients and instead pressured and incentivized their financial advisors to cause clients to be placed in proprietary funds and investments on which JPMorgan would earn substantial management fees. This skewed policy and practice caused Defendants to breach the fiduciary and contractual obligations owed to Defendants' clients.

1. Defendants Provided Improper Financial Incentives To Their Financial Advisors To Place Clients In Defendants' Proprietary Funds And Investments

50. Defendants generously rewarded their employees for placing clients into funds and investments managed by JPMorgan affiliates or subsidiaries. To induce their financial advisors to breach their fiduciary duties and contractual obligations to their clients, Defendants promised large bonuses and other benefits to employees who were able to reach certain benchmarks, which only

came from ignoring their fiduciary and contractual responsibilities by placing clients in JPMorgan proprietary funds and investments, regardless of whether such investments were in the clients' best interests.

51. According to a July 2, 2012 article in *The New York Times* entitled "Former Brokers Say JPMorgan Favored Selling Bank's Own Funds Over Others," numerous former JPMorgan financial advisors acknowledged that the incentives and pressure placed on them to sell JPMorgan funds and investments, without researching and analyzing alternatives as expected by their clients, was substantial. Quotas were set and high bonuses were promised to those financial advisors who used proprietary funds and investments, rather than other independently-researched alternatives. The work environment created by senior management's skewed incentive policies was such that the financial advisors could not survive if they performed the services that they were supposed to for their clients.

52. For example, JPMorgan established a compensation structure that was not based on client performance, but instead was based on certain "Metrics" that resulted in a "salary plus bonus" compensation structure incentivizing employees to sell certain products and meet sales quotas similar to a commission-based system. The vast majority of the employees' compensation came from the "bonus" portion of the "salary plus bonus" system, with the "bonus" factoring in the employees' performance in obtaining net new clients, assets management, revenues, and "flows" for JPMorgan.

53. Under JPMorgan's "Metrics" system, "bonuses" were paid to sales teams which, in turn, had discretion to funnel the bonus pool to the salesmen who produced the most for JPMorgan. This incentivized JPMorgan employees to push new proprietary products even if the client did not need them and to sell existing investments so that the client had the cash or margin available to buy proprietary JPM investments.

2. Defendants Placed Extraordinary Pressure On Their Financial Advisors To Place Defendants' Clients In Their Proprietary Funds And Investments

54. In addition providing their financial advisors with improper financial incentives, Defendants subjected their financial advisors to intense pressure to place clients in proprietary products in breach of the fiduciary duties and contractual obligations owed to clients. Notably, Defendants' employees were instructed not to bother conducting the research and analysis necessary for client investments, in breach of their fiduciary and contractual obligations to their clients.

55. As reported in a July 11, 2012 article in *The New York Times* entitled "Many Regulators Put Their Attention on How JPMorgan Marketed Its Funds," "[s]everal brokers told *The New York Times* that they had been encouraged to favor [JPMorgan] funds, and they described a broader culture that emphasized sales over client needs." Warren Rockmacher, a

broker who recently left JPMorgan, said: "It was all about the money, not the client." As *The New York Times* reported, Mr. Rockmacher said that, if he did not persuade a client to invest in the CSP, a manager would ask him why he had selected something else. This type of scrutiny from a supervising manager represents undue pressure intended to cause, and causing, the breaches of fiduciary duties and contractual obligations described herein.

56. As another example, JPMorgan management sent an email to certain employees warning that management would "recognize those Teams that accomplish their goal [*i.e.*, investment quota] as well as those that do not. Enough said?"

57. According to a July 3, 2012 article in *The New York Times* entitled "Conflict Seen in Sales Tactic at [JPM]," JPMorgan made it a point to honor those employees that sold the most proprietary funds and investments by circulating a list of financial advisors whose clients collectively have the largest amounts in the CSP, with "[t]op advisors hav[ing] nearly $200 million of assets in the program."

58. JPM also instituted a practice of holding Monday morning conference calls (the "Monday Morning Calls") in which all financial advisors and branch managers were encouraged to call in to hear the latest investment ideas from JPMorgan's portfolio management team in New York. These calls – which emanated from JPMorgan's home office and which were often led by Mary Erdoes, the CEO of JPMorgan's Asset Management Division – would regularly encourage financial advisors to sell this or

that JPMorgan proprietary fund above all else, stating that no other research or analysis needed to be done because it was already vetted and approved by the portfolio management team in New York.

59. In this way, the message emanating from the top was clear: sell JPMorgan proprietary products, and especially CSP, because those that do will be rewarded, and those that do not, will be ignored and left behind. As Mathew Goldberg, a former JPMorgan financial advisor, explained: "It said financial advisor on my business card, but that's not what JPMorgan actually let me be. I had to be a salesman even if what I was selling wasn't that great."

60. Additionally, JPMorgan supervisors put pressure on financial advisors to sell proprietary funds through the supervisory review process. If unaffiliated mutual funds were selected, the financial advisor was at greater risk for a compliance or surveillance review for concentration levels. Financial advisors who did not sell proprietary funds would receive Letters of Education, or other disciplinary action taken against them.

F. Defendants Breached Their Fiduciary Duties And Contractual Obligations To Clients In Order Generate Profits And Market Share

61. The extraordinary financial incentivizes provided to, and pressures placed on, Defendants' financial advisors had their intended effect: Defendants' financial advisors ignored their fiduciary duties and contractual obligations to their clients and instead pushed clients into Defendants' proprietary

funds and investments, regardless of whether these investments were in their clients' best interests, allowing Defendants to grow their assets under management and to collect substantial management (and other) fees.

62. Defendants' strategy – and the centralized policies and practices implemented to foster it – worked, generating tremendous fees from investments in Defendants' proprietary funds and investments, and causing Defendants' employees to stop performing the core services required by their fiduciary duties and contractual obligations (including, without limitation, the performance of skilled, objective and honest research, due diligence and analysis for clients, and the analysis of account and fee structure alternatives).

63. To take an example that is typical of what members of the Class experienced, in an email to Peter Landgraff ("Landgraff"), a Managing Director of JPMorgan, one JPMorgan client complained that "I have paid almost 50% in fees" in connection with his JPMorgan investment. In another email, the client asked to cancel his investment in JPMorgan proprietary funds, complaining that all he has "done is pay fees."

64. As another example, Landgraff sent an email advising a client to invest in JPM's funds. The client requested "bricks and mortar" investments that were highly liquid. Instead of conducting research to understand the investments that the client targeted, Landgraff blindly recommended high-risk, illiquid JPMorgan funds that bore no resemblance to the

types of investments that the client wished to purchase. Landgraff pushed his client into JPMorgan mezzanine funds and was later forced to admit that he had no understanding of what mezzanine financing actually was. But since it was a JPMorgan fund that he was incentivized and otherwise pressured to sell, he pushed it.

65. Following Defendants' policy to place clients in their proprietary funds and investments, Landgraff shirked his fiduciary duties and contractual obligations to conduct the research necessary to advise his client appropriately, opting instead to peddle more JPMorgan proprietary funds to enable JPMorgan to collect substantial fees.

66. Ultimately, JPMorgan's practice of foisting its proprietary funds and investments on clients to generate substantial management fees was successful. JPMorgan's mutual fund assets grew 29% to $114.7 billion from 2009 to 2010. In 2010, JPMorgan's mutual funds drew in over $18.6 billion, solidifying JPMorgan's place as the second most productive firm in the market at the time. Defendants' obtained this level of "success" at the expense of their clients in breach of their fiduciary duties and contractual obligations.

67. JPMorgan has already been partially called to account for its improper practices of favoring its proprietary funds and investments over those of other firms. In a 2011 arbitration case, JPMorgan was ordered to pay $373 million to resolve allegations that it had improperly favored its proprietary funds over those of another firm. This judgment, while

substantial, amounts to a slap on the wrist compared to wide-ranging, centralized strategy that impacted all JPMorgan financial advisory clients.

68. As a result of Defendants' practice of pushing their clients towards proprietary funds and investments, regardless of whether these products were in their clients' best interests, Plaintiffs and the other members of the Class suffered damages that were a direct, foreseeable, consequential and proximate result of Defendants' breaches of their contractual obligations and fiduciary duties. Plaintiffs and the other members of the Class suffered damages as a result of the breaches of fiduciary duties and contractual obligations described herein.

G. Defendants Improperly "Switched" Clients To Proprietary Funds From Other Fund Families To Obtain Additional Profits

69. In addition to pushing for new investments in proprietary funds and investments, Defendants pressured and incentived their financial advisors to engage in the questionable practice of "switching" their clients' existing investments from non-JPMorgan mutual funds to JPMorgan proprietary investments. Because mutual funds are generally considered long-term buy-and-hold investments, which have fees typically associated with short-term redemptions and switches, unjustified "switching" among fund families raises serious concerns about whether the financial advisor is acting in the client's best interests. The better practice is for financial

advisors to exchange funds within the same family of funds and avoid "switching."

70. Defendants' encouraged "switching" for two reasons. First, Defendants could collect substantial redemption or upfront fees charged to the client when the switch is completed. Second, Defendants would thereafter collect annual management fees for the funds that were moved from the non-proprietary fund or investment to the proprietary fund or investment.

71. Because of the number of ways that Defendants could benefit from "switching" from one fund family to another, Defendants' financial advisors are required to justify and document the reasons for a switch between fund families. Defendants offered bonuses and other incentives to insure that the extra scrutiny would not deter its financial advisors from "switching." In essence, Defendants incentivized its financial advisors to take actions that were likely contrary to the best interests of their clients to further JPMorgan's interest in bringing the largest amount of investor funds as possible into the JPMorgan fund family.

72. Among the more glaring examples of JPMorgan's fund switching, JPMorgan exploited its contacts with former Washington Mutual Bank ("WaMu") account holders to generate substantial fees from fund switching. On September 25, 2008, the FDIC was appointed Receiver for WaMu, and transferred all of WaMu's assets and liabilities to JPMorgan. This acquisition included over $490 billion assets and deposits, 5,400 former WaMu branches across 23 states, and over 43,000 WaMu

employees. In the first two quarters of 2008, WaMu earned $45.7 million from mutual fund and annuity fees.

73. The client assets and accounts acquired from WaMu presented a perfect opportunity for Defendants to increase their assets under management and the management fees associated therewith. To ensure that this opportunity was not missed, Defendants pressured their financial advisors, including former WaMu advisors, to switch WaMu's clients into fee-based account structures and from non-proprietary funds to JPMorgan proprietary funds and investments, without conducting the research, analysis and due diligence to establish that these account changes and switches were justified and in the best interests of the clients.

74. The WaMu account-holding clients who became Defendants' account-holding clients paid fees expecting to receive competent and diligent core services. Instead, these clients were exploited by being switched to JPMorgan proprietary funds from other fund families simply to generate increased fees for Defendants.

DEFENDANTS' MISCONDUCT CAUSED THE CLASS SUBSTANTIAL HARM

75. As a result of the misconduct described herein, all members of the Class were harmed by being forced to pay substantial fees for investment advisory services that they did not receive. Those members of the Class who were improperly switched from non-proprietary funds and investments to Defendants' proprietary funds and investments

suffered the additional harm of being forced to pay upfront fees associated with the switch.

76. Further, Defendants have been unjustly enriched by their retention of these investment advisory fees. Because Defendants did not provide the investment advisory services for which they purportedly earned the substantial fees they collected from members of the Class, it is unjust for Defendants to retain these fees.

CLASS ACTION ALLEGATIONS

77. Plaintiffs bring this action as a class action, pursuant to Rules 23(a) and (b)(3) of the Federal Rules of Civil Procedure, on behalf of the Class consisting of all financial advisory clients of Defendants from January 1, 2008 through the present (the "Class Period") who were charged investment management fees by Defendants in exchange for skilled, competent, and objective investment research and analysis, which Defendants failed to perform (the "Class"). Excluded from the Class are (i) Defendants; (ii) Defendants' directors, officers, parents, affiliates, subsidiaries, and successors; (iii) Defendants' 401(k) plan or plans, (iv) any person who participated in the wrongdoing alleged herein; and (v) the legal representative, agents, affiliates, heirs, beneficiaries, successors-in-interest, or assignees of any such excluded party.

78. The Class satisfies the numerosity, commonality, typicality, adequacy, predominance, and superiority requirements of Rule 23.

79. Specifically, the members of the Class are so numerous that joinder of all members is

impracticable. Although the precise number of Class members is unknown to Plaintiffs at this time and can be determined only by appropriate discovery, it is reasonably estimated that the Class consists of hundreds of thousands, or millions, of members who are geographically dispersed throughout the United States.

80. Because Plaintiffs, at all times relevant hereto, were clients of the Defendants and paid the same or closely similar fees for services that were not performed, Plaintiffs are members of the Class whose claims are typical of the claims of the members of the Class. All members of the Class were Defendants financial advisory clients who were damaged by the conduct complained of herein, and the harm suffered by Plaintiffs and the other members of the Class is the same and was caused by the same conduct of Defendants.

81. Plaintiffs will fairly and adequately represent and protect the interests of the Class, in that Plaintiffs have no interests antagonistic to or in conflict with those of the Class. To ensure such protection, Plaintiffs have retained competent legal counsel who are experienced in class action litigation and who intend to prosecute this action vigorously.

82. There is a well-defined community of interest in the questions of law and fact involved in this case. Questions of law and fact common to the members of the Class predominate over any questions that may affect individual members of the Class, including:

a) Whether Defendants breached contractual obligations to Plaintiffs and the other members of the Class;

b) Whether Defendants breached, or aided and abetted breaches, of fiduciary duties owed to Plaintiffs and the other members of the Class;

c) Whether Defendants failed to perform the services for which Plaintiffs and the other members of the Class expected and paid as financial advisory clients;

d) Whether Defendants have been unjustly enriched as a result of the breaches of fiduciary duties and contractual obligations described herein; and

e) The extent of damage sustained by the members of the Class and the appropriate measure of damages.

83. A class action is superior to other available methods for the fair and efficient adjudication of this controversy. The Class is readily definable, and prosecution of this action as a Class action will reduce the possibility of repetitious litigation. Information concerning the accounts of Plaintiffs and the Class and the fees and profits collected by Defendants in connection with the conduct complained of herein is available from their books and records. Plaintiffs know of no difficulty that will be encountered in the management of this litigation that would preclude its maintenance as a Class action.

COUNT I

BREACH OF CONTRACT AND THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING

84. Plaintiffs incorporate by reference each and every allegation set forth above as though fully set forth herein.

85. Plaintiffs and the other members of the Class entered into account agreements with Defendants that constitute valid contracts, executed by both parties. These contracts incorporate duties owed by Defendants arising by law, industry custom and standards, and public representations.

86. Under New York law (which governed the Defendants' standardized financial advisory account agreements), and general contract law, the conduct of each party to a contract is subject to the implied covenant of good faith and fair dealing.

87. Defendants had duties to exercise their contractual obligations to Plaintiffs and the other members of the Class with due and reasonable care, including the obligation to competently and honestly research, analyze, select investments and provide services, in exchange for account-related fees that Plaintiffs and the other members of the Class paid to Defendants.

88. Defendants breached their contractual obligations to Plaintiffs and the other members of the Class to provide the services described herein, to provide such services to Plaintiffs and the other members of the Class with due and reasonable care,

and/or negligently performed their services and responsibilities.

89. Defendants breached their contractual duties and implied covenant of good faith and fair dealing by failing to perform the services expected and required from them for which they received fees.

90. Plaintiffs and the other members of the Class have been damaged by Defendants' wrongful conduct.

91. Defendants are liable to Plaintiffs and the other members of the Class for damages sustained as a result of their breaches of contractual duties and the implied covenant of good faith and fair dealing.

COUNT II

BREACH OF FIDUCIARY DUTY

92. Plaintiffs incorporate herein by reference and reallege each and every allegation contained in the preceding paragraphs of this Complaint as if fully set forth herein.

93. Defendants owed fiduciary duties to Plaintiffs and the other members of the Class who were their financial advisory clients to act in their best interests while performing their duties and discharging their responsibilities toward Plaintiffs and the other members of the Class to competently and honestly research, analyze, and select investments and provide services, in exchange for account-related fees that Plaintiffs and the other members of the Class paid to Defendants. Plaintiffs and the other members of the Class placed their trust and confidence in Defendants and their financial advisors, who knew that Plaintiffs and the other members of the Class

were relying on this trust and confidence as financial advisory clients.

94. Defendants, acting in a negligent or grossly negligent manner, for self-interested reasons, or without due care or good faith, breached their fiduciary duties by (i) causing clients to be placed in Defendants' proprietary funds and investments without regard for whether such investments were in their clients' best interests and (ii) failing to perform their duties for Plaintiffs and the other members of the Class who were accountholders in the best interests of Plaintiffs and the other members of the Class. Defendants acted disloyally, favoring their own financial interests over the best interests of their clients, and/or did not use the skill and due care required of a fiduciary in these circumstances.

95. Defendants' conduct, as alleged herein, was undertaken with reckless or grossly negligent disregard of the rights or interests of Plaintiffs, the other members of the Class, and the public at large.

96. As a proximate result of the Defendants' breaches of their fiduciary duties, Plaintiffs and the other members of the Class suffered damages.

97. Plaintiffs have no adequate remedy at law.

COUNT III

UNJUST ENRICHMENT

98. Plaintiffs incorporate herein by reference and reallege each and every allegation contained in the preceding paragraphs of this Complaint as if fully set forth herein.

99. Defendants have been unjustly enriched through a self-dealing scheme aimed at enriching themselves at the expense of Plaintiffs and the other members of the Class.

100. Defendants received fees from Plaintiffs and the other members of the Class, directly or indirectly, by breach of fiduciary duty, violation of trust and other wrongful acts.

101. Such fees have been wrongfully retained by Defendants at the expense of Plaintiffs and the other members of the Class.

102. As a result of Defendants' unjust enrichment, Plaintiffs and the other members of the Class have suffered and continue to suffer damages.

103. Plaintiffs have no adequate remedy at law.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs and the other members of the Class pray for a judgment in their favor:

(1) for an order determining that Counts I through III of this action constitute a proper class action, and certifying the Class as defined herein and appointing Plaintiffs as class representatives and Plaintiffs' counsel as class counsel;

(2) for compensatory, special and general damages according to proof;

(3) for prejudgment interest;

(4) for appropriate equitable relief;

(5) for disgorgement of all management fees paid, directly or indirectly, by Plaintiffs and the other

members of the Class, directly or indirectly to any Defendant;

(6) for an accounting of all damages caused, directly or indirectly, by Defendants to Plaintiffs and the other members of the Class;

(7) for reasonable attorneys' fees and costs of investigation and litigation; and

(8) for such other and further relief as the interests of law or equity may require.

JURY DEMAND

Plaintiffs hereby demand trial by a jury on all issues properly triable before a jury.

Dated: November 26, 2012
Respectfully submitted,

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