

Securities Regulation Daily Wrap Up, TOP STORY—S.D.N.Y.: Trio of opinions lets fraud claims versus JPMorgan go on, but delivers other mixed results, (Mar. 31, 2014)

[Click to open document in a browser](#)

Securities (Federal) > News & Current Awareness > Securities Regulation Daily > Securities Regulation Daily Wrap Up > 2014 > March 2014 > March 31, 2014 > TOP STORY—S.D.N.Y.: Trio of opinions lets fraud claims versus JPMorgan go on, but delivers other mixed results, (Mar. 31, 2014)

By Mark S. Nelson, J.D.

A law suit alleging securities fraud against JPMorgan Chase & Co. (JPMorgan) and its CEO James Dimon may go forward, the federal court in Manhattan ruled today. The court ruled on three related cases against JPMorgan, including a derivative suit and one making claims under the Employee Retirement Income Security Act of 1974 (ERISA). The securities ruling was a split decision that keeps the plaintiffs' hopes alive regarding JPMorgan, Dimon, and another executive, but drops other bank executives from the suit. JPMorgan won dismissal of the derivative and ERISA suits.

Fraud claims. The court reached a mixed result regarding securities claims against JPMorgan and several of its directors and officers. The class plaintiffs, a collection of public pension funds, alleged violations of Exchange Act Sec. 10(b) and Rule 10b-5, and claimed the individual defendants were controlling persons under Sec. 20(a) (*In Re JPMorgan Chase & Co. Securities Litigation*, March 31, 2014, Daniels, G.).

The case arose from JPMorgan's eased risk limits for a synthetic credit portfolio (SCP) operated via the bank's chief investment office (CIO). The plaintiffs alleged that the CIO's London-based trades incurred billions in losses, which JPMorgan and Dimon publicly dismissed as nothing more than a "tempest in a teapot."

The court found that statements made by Dimon and JPMorgan executive vice president and CFO, Douglas L. Braunstein, about the bank's Q1 2012 value-at-risk (VaR) and about the bank's fortunes at an April 13, 2012, conference call were materially false when made. The court explained that under the Supreme Court's *Basic* framework, the statements were material, because full disclosure of the bank's CIO's position shortly after media reports noted large, exotic derivative positions would have altered the total mix of information available to investors.

Likewise, the plaintiffs alleged scienter against Dimon and Braunstein. Specifically, the court noted that the complaint alleged that Dimon and Braunstein were to pitch the SCP as a hedge, when the SCP's true purpose was belied by its outsized VaR and its changed policy from short to long positions. The court also found scienter was alleged against JPMorgan because the plaintiffs had adequately made this allegation against Dimon and Braunstein.

The court, however, dismissed the securities claims against Michael J. Cavanagh, Ina R. Drew, and Barry L. Zubrow. Cavanaugh was JPMorgan's executive vice president and CFO from prior to the class period to June 2010, when he took another job at the bank. Drew was JPMorgan's chief investment officer and a member of the bank's operations committee until she was terminated in May 2012. Zubrow was the bank's chief risk officer and a member of the bank's operations committee before becoming its head of corporate affairs. Zubrow said he would leave JPMorgan in October 2012.

With respect to Cavanaugh, Drew, and Zubrow, the court found the complaint failed to allege scienter because, unlike Dimon and Braunstein, the complaint lacked specifics regarding these defendants' knowledge or recklessness in not knowing key facts. The court also held that the plaintiffs failed to allege that Cavanaugh, Drew, and Zubrow were "makers" under the Supreme Court's *Janus* opinion. Similarly, Cavanaugh, Drew, and Zubrow could not be liable as control persons because the complaint failed to allege that they had actual control over a primary securities law violator.

Demand not excused. The Wayne County Employees' Retirement System brought a derivative suit on JPMorgan's behalf without making a demand on the bank's board. Specifically, the complaint alleged breach of fiduciary duty, unjust enrichment, aiding and abetting breaches of fiduciary duty, and waste. The court dismissed the complaint because it found that demand was not excused (*In Re JPMorgan Chase & Co. Derivative Litigation*, March 31, 2014, Daniels, G.).

The court found that demand was not excused for reasons of the board's risk of personal liability because the plaintiff has essentially made a *Caremark* claim and the complaint failed to allege the board consciously disregarded red flags about the CIO's risk or otherwise failed to monitor the bank's business risks. The fact that a minority of the board, Dimon, may be at risk of personal liability was insufficient to assign that risk to the remainder of the board.

The complaint likewise lacked enough details about how a majority of the bank's directors could have known of or approved the CIO's London trades. Moreover, the court ruled that allegations that two of JPMorgan's directors were conflicted did not contain enough detail to allege that a majority of the bank's directors were not disinterested or independent.

The court's ruling in the derivative suit involved two consolidated cases. A third suit, in which the plaintiff did make a demand on JPMorgan's board, had already been dismissed because the allegations there were insufficient to trump the business judgment rule.

ERISA claims. The participants and beneficiaries of JPMorgan's 401(k) plan sued the bank claiming breach of the fiduciary duties of loyalty and prudence, failure to monitor other fiduciaries, and breach of duty to avoid conflicts of interest. The complaint's allegations focus on the CIO's SCP risks and the bank's alleged failure to disclose the risks of investing in JPMorgan stock (*In Re JPMorgan Chase & Co. ERISA Litigation*, March 31, 2014, Daniels, G.).

The court ruled that the plaintiffs failed to allege that JPMorgan was in a dire situation that would overcome the prudence presumption set forth in *Moench*. The court likewise dismissed related claims over the bank's alleged failure to monitor or disclose certain information.

The cases are Nos. 12 Civ. 03852 (GBD), 12 Civ. 03878 (GBD), 12 Civ. 04027 (GBD).

Companies: JPMorgan Chase & Co.

MainStory: TopStory NewYorkNews CorporateGovernance Derivatives DirectorsOfficers FraudManipulation RiskManagement