No. 16-1536

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

REPLY BRIEF FOR THE PETITIONERS

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REPLY BRIEF FOR THE PETITIONERS

The petition documented a widely acknowledged, multi-faceted circuit conflict over when contract and breach of fiduciary duty claims relating to covered securities are extinguished by SLUSA. Respondents attempt to deny any relevant conflict by identifying a rule of decision so vague and general that all courts agree with it, then claiming that all else is fact-bound disagreement about how to apply the settled rule. That transparent gambit fails. There is no escaping that in deciding whether an allegation of a misrepresentation or omission is "[e]ssential" to a complaint, BIO 8, the circuits apply vastly different rules that regularly result in disparate treatment of similarly situated parties and, indeed, broad classes of claims. This Court should grant this petition to resolve that conflict.

I. The Circuits Are Divided.

Respondents assert that all courts "agree" that "SLUSA bars a state-law claim when a defendant's alleged misrepresentation or omission regarding a covered security is 'essential' to or the 'gravamen' of the claim." BIO 7. That is not actually true: as respondents eventually admit, the Sixth Circuit's literalist approach rejects any requirement that an alleged misrepresentation or omission be "essential" to a complaint. *See* BIO 11; Pet. 14-15. It is also beside the point. The difficulty in applying the statute – and the subject of the circuit conflict between the Seventh Circuit and other courts, as well as the Question Presented – centers on identifying *when* a misrepresentation or omission should be treated as "essential" to a complaint.

As we explained, the majority circuits hold that to be "essential" to a complaint, "the fact of a misrepresentation must be one that gives rise to liability." *LaSala v. Bordier et Cie*, 519 F.3d 121, 141 (3d Cir. 2008). If the plaintiff must prove a misrepresentation or omission to establish the elements of her claim, then the allegation is "essential" and SLUSA is triggered (assuming its other requirements are met). Otherwise, if the misrepresentation need not be proven, it is "merely an extraneous detail," *id*., which is to say, inessential, and not the "gravamen" or the "linchpin." *See* Pet. 10-14.

The Seventh Circuit, in contrast, holds that SLUSA applies so long as a defendant could avoid liability by showing that it had disclosed in advance the conduct the plaintiff says breached a contract or fiduciary duty. Pet. App. 3a. When that is true, the court held, that "means that nondisclosure is a linchpin of th[e] suit no matter how [the plaintiff] chose to frame the pleadings." *Id*. As this case illustrates, under that rule, SLUSA applies even if the plaintiff has no need to prove any omission or misrepresentation in order to establish her case. To prove breach of fiduciary duty, for example, it would be enough to prove that respondents subordinated petitioners' interests to JPMorgan's. The gravamen of the tort lies in the defendants' actions, not their words. *See* Pet. 20; *Brown v. Calamos*, 664 F.3d 123, 129 (7th Cir. 2011).

Moreover, even assuming other courts would consider potential defenses – which they do not, *see infra* pp. 4-7 – respondents have never suggested that they would actually raise a disclosure defense (*i.e.*, that they informed petitioners they would be pursuing JPMorgan's financial interests rather than their clients'). Accordingly, there is no reason to think that any question of disclosure or omission would *ever* arise in this case.

It is no accident, then, that respondents provide no citation (other than the Seventh Circuit's similarly unsupported assertion) for their claim that petitioners "could not . . . prevail simply by demonstrating that JPMorgan steered plaintiffs' money toward its affiliates' fund even if that was sub-optimal for clients" and that they would "have to prove that [respondents] did so without telling clients, or after telling them that it would act in their best interest." BIO 22. The whole point of fiduciary duty law is to impose an obligation to act in the clients' best interest even if the fiduciary never promised to do so. And petitioners have no obligation to negate a disclosure defense respondents have never even offered.

The Seventh Circuit thus was forced to find an *implied* allegation of an omission arising from the merely theoretical possibility that *some* defendant, in *some* hypothetical similar case, could avoid liability by proving it disclosed its planned conduct at the outset.

Respondents do not deny that the consequence of that rule is to preclude class litigation of the vast majority of contract and fiduciary duty claims regarding covered securities. *Compare* Pet. 18-19 (citing Pet. App. 5a, 8a), *with* BIO 23. They cannot claim that any other circuit has adopted that rule. Indeed, their attempts to show that this case would have come out the same way in other circuits only illustrates that the opposite is true.

Ninth Circuit. Respondents do not address petitioners' showing that the Ninth Circuit's decision in *Freeman Investments, L.P. v. Pacific Life Insurance Co.*, 704 F.3d 1110 (9th Cir. 2013), would have come out the opposite way under the Seventh Circuit's rule. Pet. 21. Instead, respondents say this case is different from *Freeman* because petitioners do not "point to any explicit [contract] term" that JPMorgan allegedly violated. BIO 21.[1] But nothing in either *Freeman* or this case turned on any citation (or lack thereof) to a particular paragraph of a contract. *Freeman* turned on the fact that to "succeed on [the contract] claim, plaintiffs need not show that Pacific misrepresented the cost of insurance or omitted critical details." 704 F.3d at 1115. And petitioners' contract claim failed because JPMorgan could have defeated it by showing it had disclosed its self-dealing. Pet. App. 3a.

Respondents insist (BIO 20-21) that petitioners' fiduciary duty claim would have been rejected in the Ninth Circuit, pointing to *Proctor v. Vishay Intertechnology Inc.*, 584 F.3d 1208 (9th Cir. 2009).

[1] *But see* Pet. 4 (citing Complaint ¶¶ 28-40); Complaint ¶ 28 (explaining that under "standardized account agreements" respondents "contracted to comply with all laws . . . applicable to banks, brokerage firms, and investment advisors" as well as "representations made in marketing and advertising" and "duties arising from common law"); *id.* ¶¶ 33-40 (describing the specific provisions of SEC filings and other documents thus incorporated into the contract).

But that case nicely illustrates the distinction the Seventh Circuit ignores. In *Proctor*, the Ninth Circuit applied SLUSA because the plaintiffs alleged that the defendants breached their fiduciary duty *by lying to them* about the company's affairs in order to purchase minority shareholders' stocks at suppressed prices. *Id*. at 1221-22. In order to prevail on *that* claim, the plaintiffs *would* have to prove the alleged misrepresentations. In contrast, petitioners' allegation here is that respondents breached their fiduciary duty of loyalty by engaging in self-dealing, a claim that does not depend on any misrepresentation or omission.

Second Circuit. Respondents make a similar mistake in arguing that petitioners' claims would be precluded in the Second Circuit under *Romano v. Kazacos*, 609 F.3d 512 (2d Cir. 2010). The plaintiffs in *Romano* asserted that the defendants breached their contract and fiduciary duty by "misrepresenting that if appellants were to retire early, their investment savings would be sufficient to support them through retirement." *Id*. at 515; *see also id.* at 521. On that theory, the allegations of misrepresentation were essential because the plaintiffs could not prevail without proving them.

This case, instead, is on all fours with *In re Kingate Management Ltd. Litigation*, 784 F.3d 128 (2d Cir. 2015). There, the plaintiffs invested in a fund under a contract that required the fund managers to "evaluate and monitor [an outside] investment advisor." *Id*. at 134. Those promises were false from the outset, as the money was instead used for a Ponzi scheme. *Id*. at 133. The plaintiffs sued, alleging, among other things, that the defendants breached their contract by "fail[ing] to perform the duties for which the fees were paid," and by computing fees "on the basis of inaccurate values." *Id*. at 152.

In the Seventh Circuit, those claims would have been held precluded because the defendants would avoid liability if they had disclosed up front that they had no intention of complying with their contractual obligations and described how they would compute their fees. Pet. App. 3a, 9a-10a. The Seventh Circuit would have held that such claims are "a staple of federal securities law" and therefore must be pursued as such. *Id*. 7a.

But the Second Circuit held that the contract claims "do not require a showing of false conduct on the part of Defendants," and therefore saw "no basis for applying SLUSA to these claims." 784 F.3d at 152.

Third Circuit. Respondents say (BIO 19-20) the Third Circuit applied SLUSA to allegedly indistinguishable claims in *Rowinski v. Salomon Smith Barney Inc.*, 398 F.3d 294 (3d Cir. 2005). Not so. The exact rationale in *Rowinski* was unclear, leading some courts to wonder if the Third Circuit had adopted a literalist approach.[2] But the Third Circuit's position was cleared up in *LaSala*. There,

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[2] Respondents rely on that uncertainty in a misguided attempt to confuse the circuit split. *See* BIO 14 (noting Second Circuit's statement of possible disagreement with *Rowinski*, assuming it adopted a literalist approach); BIO 9-10 (discussing Sixth Circuit's embrace of *Rowinski* on premise that *Rowinski* adopted a literalist approach).

the court explained that *Rowinski* understood the plaintiffs in that case to be alleging that the defendant breached the contract *by making a misrepresentation*. *See* 519 F.3d at 141 ("Thus, when, as in *Rowinski*, a plaintiff alleges that a *misrepresentation . . . breaches a contract*, the plaintiff cannot avoid SLUSA preemption by arguing that misrepresentation is not an element of a breach-of-contract action.") (emphasis added); *see also Rowinski*, 398 F.3d at 299-300.

The *LaSala* court thus explained that *Rowinski* had applied the rule that an allegation of misrepresentation "operates as a factual predicate" to a claim, and therefore triggers SLUSA, only if the "fact of a misrepresentation [is] one that gives rise to liability." 519 F.3d at 141. The court then applied that rule to the case before it, finding that the allegations of misrepresentation alleged in the complaint "have no bearing on whether the Banks' conduct is actionable" under Swiss fiduciary duty law. *Id.* That rule, and the result in *LaSala*, cannot be reconciled with the Seventh Circuit's implied omission standard adopted here. Pet. 21-22. [3]

II. The Question Presented Is Recurring And Important.

Respondents do not dispute that the Question Presented is recurring. *See* Pet. 23-24; BIO § II.

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[3] Respondents say the Third Circuit could have decided *LaSala* on a different ground (*i.e.*, that the misrepresentations were made by third parties, not the defendant). BIO 20. But it plainly did not.

And, as noted, they provide no basis to doubt that under the Seventh Circuit's rule, a substantial portion of all of breach of contract and fiduciary duty claims relating to covered securities are barred by SLUSA.

But respondents say the Question Presented is nonetheless unimportant because an unduly broad application of SLUSA only deprives investors of remedies for claims relating to covered securities, allows investors to bring individual claims, and does not prevent SEC enforcement actions. BIO 23-26. The Seventh Circuit itself, however, emphasized the breadth of its ruling, cataloging the variety of claims that it says federal law permits (and SLUSA requires) to be brought as federal securities class actions rather than contract or breach of fiduciary duty claims. Pet. App. 7a-10a. And respondents cannot bring themselves to deny that many of those claims are too small to be brought as anything other than class actions. *Compare* Pet. 24, *with* BIO 25.

Respondents' assertion that the SEC can fill the enforcement gap is wrong. The problem is not that the Seventh Circuit's rule subjects contract and fiduciary duty claims "to the limitations of the [Private Securities Litigation Reform Act of 1995]." BIO 25. It is that such claims are subject to the scienter requirement of federal securities laws, which applies equally to any SEC enforcement action. *Aaron v. SEC*, 446 U.S. 680, 695 (1980). The consequence is that perfectly ordinary and viable breach of contract and fiduciary duty claims cannot be brought directly as state law class actions, are not valuable enough to bring as individualized state claims, and are unwinnable if brought as federal securities claims.

For example, there was no plausible claim of scienter in *Freeman*, given the parties' genuine disagreement over what fees the relevant contract allowed the defendants to charge. *See* 704 F.3d at 1114, 1115. So there could be no federal securities class action. At the same time, the Seventh Circuit would prohibit a state law class action under SLUSA because the defendants would not have violated the contract if they had disclosed their fee calculations at the outset. Pet. App. 3a. That leaves only individual state law suits, but the overcharges were surely too small to justify individual actions.

This case is thus crucially different from *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71 (2006), in which there was no question that the defendant's conduct was actionable under federal law, if only in a suit by the SEC. *See id*. at 81, 83-84; *but see* BIO 26-27.

The complete gap in enforcement left by the Seventh Circuit's decision not only denies victims any remedy, but removes an important incentive for firms like JPMorgan to carefully monitor their compliance with their contractual and fiduciary duties, rather than simply ensuring that their employees do not engage in intentional fraud.

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

Respondents do not seriously dispute that if the circuits are split along the lines petitioners describe, this case presents the Court an appropriate vehicle to resolve the conflict. Respondents say the Sixth

Circuit's rule is not implicated in this case because the Seventh Circuit did not rely on it. BIO 11-12. But they do not deny that this case presents a vehicle for comprehensively resolving the entire circuit conflict, given that the Amended Complaint here would fail the literalist test. *See* Pet. 25-26.

IV. The Decision Below Is Wrong.

Respondents' defense of the decision below only illustrates how far the Seventh Circuit has departed from established principles of statutory construction. In their argument on the merits, respondents fail even to cite, much less quote and analyze, the governing statutory language. *See* BIO 26-29. Instead, Seventh-Circuit-style, respondents muse over what rule "makes sense," BIO 28, concluding that SLUSA should be construed to cover any action that falls "within the scope of the federal securities law." *Id*.

But the plain text of the statute applies SLUSA only to cases in which the plaintiff is "alleging" a misrepresentation or omission. 15 U.S.C. § 78bb(f)(1). Respondents do not defend the literalist position that a plaintiff is "alleging" a misrepresentation or omission whenever a misrepresentation or omission is described in the complaint. *See* BIO 26-28. Nor do they explain why petitioners and the majority of circuits are wrong to think that "alleging" refers to *material* allegations, that is, "charges of misconduct for which the plaintiff is seeking relief." *Brown*, 664 F.3d at 128; *see also Material Allegation*, BLACK'S LAW DICTIONARY 87 (9th ed. 2009) ("In a pleading, an assertion that is essential to the claim, charge, or defense . . . .").

Instead, they say that the Seventh Circuit's rule is "consistent with" two of this Court's prior decisions. BIO 26. But neither is on point. In *Dabit*, the complaint indisputably depended on allegations of misrepresentation in the sense required by the majority circuits – the defendant allegedly breached its contract and fiduciary duties when it "misinformed brokers to enhance the prices of its investment banking clients' stocks." 547 U.S. at 75. The issue for this Court was whether SLUSA applied even though the plaintiffs (holders of the securities) had no implied private right of action for damages under the federal statute. *Id*. at 84.

Likewise *Wharf (Holdings) Ltd. v. United International Holdings, Inc.*, 532 U.S. 588 (2001), might at best suggest that a contract claim like petitioners' could be pled as a federal securities claim. But that simply begs the question whether SLUSA precludes state law claims that *could have* been pleaded as federal securities claims, even when the actual complaint alleges instead an ordinary contract or breach of fiduciary duty claim that depends in no way on any misrepresentation or omission.

Finally, respondents say that it "makes sense" to apply SLUSA whenever a claim falls "within the scope of the federal securities law." BIO 28. Of course, as discussed, respondents a funny idea of what counts as falling "within the scope" of federal securities law, given that their rule sweeps in cases that indisputably fall *outside* the scope of federal securities law because the defendant acted without scienter.

But even setting that aside, respondents' assertion (BIO 28) that petitioners' claims fall within the scope of federal securities law depends on: (a) the fiction that the complaint "allege[d]" an omission because disclosure might be a defense to the state law claims; (b) the mere happenstance that the complaint unnecessarily alleged misrepresentations as background, when the state law claims could survive without the allegations; or (c) the possibility that plaintiffs *could have* included material allegations of misrepresentation that stated a claim under federal securities laws given the facts of the case. Respondents are unclear which theory they are pursuing, but none has anything to do with the text of the statute. That text requires an actual allegation of misrepresentation or omission; it is not enough that the facts would have supported such an allegation or that a court hypothesizes that a disclosure issue might arise later in the case. Nor is the statute reasonably read to turn on the mere happenstance that a plaintiff has included *immaterial* allegations of misrepresentation that are unnecessary to the claims pleaded. If the law were otherwise, SLUSA would turn on the artfulness of the plaintiffs' pleading, rather than the substance of their claims.

CONCLUSION

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

Respectfully submitted,

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