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Wells Fargo Beats $800M Investor Suit Over 2018 Fund Purge

By **Jon Hill**

Law360 (September 18, 2023, 8:38 PM EDT) -- A New York federal judge has freed Wells Fargo from a potentially $800 million proposed class action accusing the bank of wrongfully forcing the costly liquidation of a Chicago fund manager's mutual fund and other investments in the wake of a 2018 volatility shock.

In a Friday decision, U.S. District Judge Laura Taylor Swain granted full dismissal of the case to Wells Fargo Securities LLC, which had served as clearing broker to several investment funds run by Chicago-based LJM Partners and an affiliate, including LJM Preservation and Growth Fund, a publicly traded mutual fund.

The suit, filed by fund investors Joseph and Todd Kafka, alleged the Wells Fargo unit had unnecessarily and recklessly ordered LJM to dump fund assets in response to a brief February 2018 stock market rout and spike in volatility popularly known as Volmageddon.

The Kafkas said this fire sale caused them and other fund investors to collectively suffer $500 million to $800 million in losses. Their nearly 20-count suit sought to hold Wells Fargo liable for those alleged losses, asserting claims for negligence, tortious interference, breach of contract and more.

But Judge Swain declined to let any of those claims proceed Friday. For one, although Wells Fargo might have owed a "duty of care" to its customer LJM, the Kafkas failed to show legally that this duty "encompasses the need to protect the customer's investors," the judge said.

"Where there is no duty, there is no negligence claim," Judge Swain wrote.

To state a valid claim for tortious interference, meanwhile, the judge said the Kafkas needed to make a plausible showing that Wells Fargo had acted with "specific animus" toward them and other fund investors when ordering the liquidation.

But the suit's allegations on this point were "simply insufficient," according to the judge. Nowhere did the Kafkas allege Wells Fargo "affirmatively wanted LJM to breach its contracts with the plaintiffs, or with any of its customers," the judge said.

"It is reasonable to infer that ordering the wholesale liquidation of a portfolio would, among other things, injure LJM's investors. But that showing is insufficient to show WFS possessed the requisite intent under Illinois law," Judge Swain wrote.

The judge also rejected claims that Wells Fargo's actions had breached its own service agreements with LJM, which relied on the bank as one of its futures commission merchants, or FCMs, for options trading.

Those claims were brought derivatively, with the Kafkas alleging they and other fund investors were "intended third-party beneficiaries" of LJM's agreements with Wells Fargo. The agreements themselves, however, preclude such a possibility, according to the judge.

"The Kafkas cannot bring a breach of contract claim as intended third-party beneficiaries for the simple reason that the FCM agreements expressly disclaim the existence of third-party beneficiaries to the contract," Judge Swain wrote.

Although counsel for the Kafkas declined to comment Monday on Judge Swain's decision, they are moving to fight the dismissal. In a notice filed Monday, the Kafkas indicated that they intend to appeal to the Second Circuit.

A Wells Fargo spokesperson declined to comment Monday.

The Kafkas had sought to represent a class of potentially thousands of investors who held stakes in either the LJM Preservation and Growth Fund or certain other limited partnership funds under the LJM umbrella.

The volatility surge that hit markets in February 2018 caught LJM short and is said to have resulted in trading losses of more than $1 billion for its funds, or roughly 80% of their value. LJM, which subsequently closed down the funds, had been using options to effectively bet against the possibility of big market swings.

The episode has led to multiple lawsuits, including one in which Wells Fargo has sued LJM to recover more than $16 million in allegedly unpaid margin. Federal regulators have also sued LJM, its founder and another one of its senior leaders for allegedly downplaying investor risks, claims they have denied.

The Kafkas are represented by Mark C. Rifkin of Wolf Haldenstein Adler Freeman & Herz LLP and Kenneth Gilman of Gilman Law LLP.

Wells Fargo Securities is represented by Christopher Houpt, Benjamin D. Bright, Lucia Nale, Hans Germann and Matthew Fenn of Mayer Brown LLP.

The case is Kafka et al. v. Wells Fargo Securities LLC, case number 1:22-cv-01034, in the U.S. District Court for the Southern District of New York.

--Editing by Janice Carter Brown.
