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UNDERWRITING - MICHIGAN

In re Flint Water Cases

United States District Court, E.D. Michigan, Southern Division - March 29, 2022 - Slip Copy - 2022 WL 957542

Plaintiffs brought suit against Defendant financial institutions – J.P. Morgan Securities LLC, Wells Fargo Bank N.A., and Stifel, Nicolaus & Company, Inc. – that acted as underwriters for approximately $300 million in municipal bonds used to fund the infrastructure behind the Karegnondi Water Authority ("KWA"). The KWA is a municipal water supply system, incorporated under Michigan law, whose formation required the installation of a water intake structure, pipelines, and multiple pumping stations to process and distribute raw water to an area in the State of Michigan including the City of Flint.

Plaintiffs alleged that Defendants conspired with various governmental officials to violate Plaintiffs' bodily integrity when Defendants underwrote the bonds that funded the KWA project. They also allege that Defendants were professionally negligent when they failed to require that the Flint Water Treatment Plant ("FWTP") be upgraded or that there exist a feasible funding mechanism to pay for the necessary upgrades.

The District Court held that:

- Plaintiffs' conspiracy claim failed because it did not allege that Defendants acted with the purpose of violating their constitutional rights, nor did Plaintiffs plead the alleged conspiracy with sufficient specificity;
- Plaintiffs did not adequately plead that Defendants acted under color of state law;
- As to its ordinary negligence claim, Plaintiffs failed to sufficiently allege a relationship between Defendants and Plaintiffs sufficient to create a duty of care; and
- Even if the Court had found that Plaintiffs had adequately pleaded that a legal duty existed to sustain a negligence claim, that claim fails on public policy grounds.

"Defendants ultimately aimed to secure a deal and sell the bonds at a favorable rate. To be sure, Defendants' conduct was one step in the causal chain that ultimately led to the violation of Plaintiffs' rights. But even as Plaintiffs tell the story, Defendants did not have the objective of violating Plaintiffs' rights. At most, Defendants acted without considering the possible harm to Plaintiffs. A section 1983 conspiracy claim requires a 'single plan' with the 'objective to deprive plaintiffs of their constitutional rights,' *Marvaso*, 971 F.3d at 606. To the extent it is possible to conspire to be careless, such a conspiracy would be legally insufficient to make out a claim under section 1983."

"Plaintiffs' allegations that a reasonable underwriter would not have funded the KWA project in light of the City's finances and the condition of the FWTP may be more properly understood as an argument that underwriters have a duty to evaluate the externalities of the municipal projects they fund before they fund them. But even if the Court were to accept this as true, which it does not, it does not follow that Defendants here conspired with state actors to violate Plaintiffs' rights."

"The issuing of a loan is therefore not an undertaking that ordinarily gives rise to a duty of due care

to third parties. As Plaintiffs acknowledge, the underwriting of a municipal bond is a kind of lending. Accordingly, Plaintiffs have not shown that Defendants' underwriting of the KWA bonds gave rise to a duty of reasonable care to avoid harms to Plaintiffs."

"SIFMA persuasively argues that under Plaintiffs' theory, '[u]nderwriters would suddenly be responsible to a municipality's residents for judgments made by elected officials as to how best to govern, manage, and operate their own city, town, or state—matters over which the underwriters have no control.'"

"KWA is a municipal entity. Those who determined whether and how to build the KWA project were elected officials and individuals appointed by elected officials. Those officials answer to the public through the political process, and in this case, some of them answer through the judicial process. Imposing a duty on Defendants could result in our nation's banks making decisions on behalf of municipalities. Banks are not accountable to the public in the voting booth. On balance, the burdens and benefits weigh against imposing a duty on Defendants in this case."

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