IN THE SUPREME COURT OF GEORGIA

S09Q1585

WILLIAM K. HOLMES, HOLMES CAPITAL, LLC, BREW DOG, LLC, BIMINI STAR, LLC, and EBH INVESTMENTS CO., LLC,

Plaintiffs-Appellants,
-v.-

JACK GRUBMAN and CITIGROUP GLOBAL MARKETS, INC. f/k/a SALOMON SMITH BARNEY & CO., INC.,

Defendants-Appellees.

Certified Questions From
The United States Court Of Appeals For The Second Circuit

AMICUS CURIAE BRIEF OF PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION

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INTRODUCTION

The Public Investors Arbitration Bar Association, Inc. ("PIABA") respectfully submits this Brief as Amicus Curiae. Founded in 1990, PIABA is a national, non-profit, voluntary, public bar association with a membership of over 450 attorneys who devote a significant portion of their practice to representing public investors in disputes against brokerage firms, brokers, and financial advisors. PIABA members have represented tens of thousands of investors in such disputes.

PIABA has an interest in the outcome of this case because its members represent public investors who relied to their detriment on brokerage firms to be trusted advisors that could provide competent advice and management of their finances. As this case illustrates, there is a wide gulf between the representations that brokerage firms make to attract and keep clients, and their denial of fiduciary and other essential responsibilities owed an investor after that investor makes a complaint.

PIABA urges this Court to answer affirmatively each of the questions certified by the Second Circuit. Doing so will help to enhance protections afforded by Georgia law to investors who use and rely upon their brokers to make, manage or advise on investments.

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I. GEORGIA RECOGNIZES A COMMON LAW FRAUD CLAIM BASED ON FORBEARANCE IN THE SALE OF PUBLICLY TRADED SECURITIES.

A. Existing Georgia Law Recognizes a Common Law Fraud Claim Based on the Forbearance in the Sale of Publicly Traded Securities.

While this Court has not directly considered whether there exists a legally cognizable common law fraud claim under Georgia law based on forbearance in the sale of publicly traded securities ("holder claims"), existing Georgia law confirms that it is a viable claim.

There can be no dispute that an element of fraud includes an "intention to induce the plaintiff to act *or refrain from acting*." *Stiefel v. Schick*, 260 Ga. 638, 639, 398 S.E.2d 194, 195 (1990) (emphasis added) (quotation marks omitted). It is a basic tenet of common law fraud that reliance can either take the form of action or forbearance induced by misrepresentations. Indeed, the *Restatement (Second) of Torts* regularly viewed as persuasive authority by this Court[1] and other courts,

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[1] *See, e.g., City of Atlanta v. Kleber*, 285 Ga. 413, 415, 677 S.E.2d 134, 136 (2009) (looking to Restatement of Torts to evaluate nuisance claim); *Orkin Exterminating Co. v. Martin Co.*, 240 Ga. 662, 667, 242 S.E.2d 135,139 (1978) (adopting the theory of privilege of fair competition as set out in Restatement of Torts).

supports a common law fraud claim based on forbearance. *See* Appendix "A". Section 525 provides that:

> [o]ne who fraudulently makes a misrepresentation of fact, opinion, intention or law for the purposes of inducing another to act ***or to refrain from action*** in reliance upon it is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation.

Restatement (Second) of Torts §525 (1977) (emphasis added).

The Second Circuit in the instant case explained that the Georgia Court of Appeals has "touched on" the applicability of this fraud element in the context of holder claims. *Holmes v. Grubman*, 568 F.3d 329, 336 (2d Cir. 2009). The only two cases cited by the Second Circuit were *Argentum Int'l, LLC v. Woods*, 280 Ga. App. 440, 634 S.E.2d 195 (2006) and *Mack v. Smith*, 178 Ga. App. 652, 344 S.E.2d 474 (1986).

Argentum Int'l, LLC v. Woods squarely deals with a holder claim. The plaintiffs in *Argentum* held their securities and refused to accept defendant's offer to repurchase their securities based on defendant's representations that the major asset of the company in which they were invested was not at risk. In affirming judgment in plaintiffs' favor, the Court found that plaintiffs presented evidence sufficient to establish "that they were fraudulently induced into making *and* *keeping their investments*." 280 Ga. App. at 445, 634 S.E.2d at 202 (emphasis added).

In stark contrast to *Argentum, Mack v. Smith* provides absolutely no guidance whatsoever with respect to "holder claims," as the plaintiff in that case made no purchase of any securities or investment contracts. 178 Ga. App. at 652, 344 S.E.2d at 475. Thus, *Mack* clearly has no precedential value with respect to holder claims and no other cases cite to *Mack* in the context of determining liability in the holder context. In fact, the Court of Appeals affirmed the dismissal of plaintiff's common law fraud claim not on the basis that Georgia does not recognize holder claims, but rather on the grounds that the complaint "disclose[d] no invasion of Plaintiff's person or property by the Defendants which is legally sufficient to sustain an award of general or nominal damages . . . [thus] Plaintiff has . . . failed to state a claim for common law fraud upon which relief can be granted." *Id.*

B. Public Policy Supports the Viability of a Common Law Fraud Claim Based on Forbearance in the Sale of Publicly Traded Securities.

1. Weighing Public Policy Concerns, the Scales Tip in Favor of Recognition of a Common Law Fraud Claim in Holder Cases.

Concerns over recognizing a common law fraud claim in holder cases have their genesis in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 95 S.Ct. 1917 (1975), which held that a claim for violation of Rule 10b-5 under the 1934 Act could not be maintained unless there was a purchase or sale. The Supreme Court based its decision predominantly on two policy concerns. First, that expanding the class of plaintiffs under Rule 10b-5 who neither purchased nor sold securities may have the potential for nuisance or strike suits[2] and, second, problems of proof which would depend almost entirely on oral testimony. *Id.* 421 U.S. at 741-44, 95 S.Ct. at 1927-1929. Neither of these concerns should foreclose redress to an aggrieved investor who was damaged as a result of retaining securities based on fraudulent representations directed to the investor by their broker.

With respect to the first concern, there is no empirical evidence that permitting common law fraud claims in holder cases leads to nuisance or strike suits.[3] To the contrary, "[t]he last few years have seen repeated reports of false

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[2] We are not advocating here that a fraud claim should be recognized for parties who never owned the relevant security, i.e., investors who claim they were dissuaded from purchasing a security due to fraud or misrepresentation. Rather, our position is that a fraud claim should be recognized in cases where an investor was induced, by fraud, to continue to hold a security.

[3] Brief for New York et al. as Amici Curiae Supporting Respondent, *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 126 S.Ct. 1503 (2006) (No. 04-1317), WL

financial statements and accounting fraud, demonstrating that many charges of corporate fraud were neither speculative nor attempts to extort settlement money, but were based on actual misconduct." *Small v. Fritz Companies, Inc.*, 65 P.3d 1255, 1263 (2003). "Eliminating barriers that deny redress to actual victims of fraud now assumes an importance equal to that of deterring nonmeritorious suits." *Id.*, 65 P.3d at 1264.

With respect to the second concern, proof problems exist in non-holder cases just as they do in holder cases. "The possibility that a shareholder will commit perjury and falsely claim to have read and relied on the report does not differ in kind from the many other credibility issues routinely resolved by triers of fact in civil litigation. It cannot justify a blanket rule of nonliability." *Id.*[4]

3543088 at *18 (discussing that the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") does not preempt state law claims for plaintiffs who were fraudulently induced to hold a security and that "there is no evidence that allowing States to make remedies available for holder claims has led or will lead to a flood of frivolous strike suits.")

[4] *See also, Continental Insurance Co. v. Mercadante*, 225 N.Y.S. 488 (N.Y. App. Div. 1st Dep't 1928) ("Where the damage is caused by inducing plaintiff's inaction, it is necessarily more difficult to allege or prove causation than in those cases where active conduct is induced. Indeed, in all fraud cases the element of proximate cause is more impalpable than in negligence cases because we are dealing with the plaintiff's state of mind. The defendants cannot, therefore, require the same exact proof of causation.")

There are other legitimate policy concerns of equal or greater import that militate in favor of recognition of a common law fraud claim in holder claims. First, the law should provide a remedy for investors who are defrauded regardless of whether the fraud induced action or inaction.[5] Second, there is no principled reason why investors who are induced to retain their securities based on misrepresentations should be treated any differently from investors who purchased or sold securities based on misrepresentations.[6] Third, states have a strong interest in protecting their citizens from fraud in securities transactions, maintaining

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[5] "[T]he extension of [the definition of actionable deceit to include misrepresentations that induced the retention of securities] is based upon a proper commercial morality and the logical import of the precedents that the purpose of the law is, wherever possible, to afford a remedy to defeat fraud." *Mercadante*, 225 N.Y.S. at 187.

[6] "[I]nvestors induced to hold a security are at least as vulnerable to fraud as those induced to purchase or sell a security." Brief for New York et al. as Amici Curiae Supporting Respondent, *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 126 S.Ct. 1503 (2006) (No. 04-1317), WL 3543088 at *15. "There is no critical distinction between fraudulent buy/sell advice and fraudulent advice that induces a claimant to hold securities to his detriment. Inducing an investor to hold securities places him in the same economic position as if the broker advised him to buy the security." Steckman and Conner, *The Unsuitability of the "Suitability Rule": Why FINRA's Current Interpretation of Conduct Rule 2310 Undermines Investor "Holding Claim" Entitlements in Contemporary Markets*, 2 J. Bus. Entrepreneurship & L. 122, 140 (2008). Securities regulators have further concluded that the duty to recommend only suitable investments encompasses a recommendation to "hold." *See*, fn.14, *infra*.

integrity in the marketplace, and rebuilding investor confidence, particularly in light of major corporate scandals -- such as the WorldCom scandal that precipitated this action -- that have been revealed in recent years and that have depleted the life savings of millions of investors.[7] Fourth, as detailed in the immediately following section of this Brief, investors fraudulently induced to retain their securities would be left with no remedy in the absence of a state common law fraud remedy.[8]

2. The Only Avenue Available to Investors to Assert Holder Claims is State Common Law.

The door has been shut on investor holder claims under both federal and state securities laws; thus, the only avenue available to investors to seek redress for fraudulent advice to forbear from selling their securities is state common law. It is well-settled since the decision in *Blue Chip Stamps, supra,* that nonpurchasers or

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[7] "There are . . . strong countervailing policy arguments in favor of allowing a holder's cause of action. [The state] . . . has a legitimate and compelling interest in preserving a business climate free of fraud and deceptive practices. . . . The SEC repeatedly has noted that government regulation alone is not sufficient to keep markets honest. It has consistently stated that the private civil remedy is a key element in establishing a trusted market in which individuals and pension funds could safely invest. Denying a cause of action to persons who hold stock in reliance on corporate misrepresentations reduces substantially the number of persons who can enforce corporate dishonesty." *Small v. Fritz Companies, Inc. infra*, 65 P.3d at 1264 (internal quotations and citations omitted.)

nonsellers may not maintain a private right of action for violation of Rule 10b-5 under the Securities Exchange Act of 1934 as there was no "purchase" or "sale" as required by the statute. *See e.g., Pension Committee of the University of Montreal Pension Plan v. Banc of America Securities, LLC*, 446 F.Supp.2d 163, 189-90 (S.D.N.Y 2006) (dismissing 10(b) claims of investors where there was no purchase or sale).); *Arlund v. Deloitte & Touche LLP*, 199 F.Supp.2d 461, 469 (E.D. Va. 2002) (holding that plaintiffs who alleged they were fraudulently induced not to sell their securities could not pursue a federal securities fraud claim because of "the settled principle that private claims under Section 10(b) of the 1934 Act and Rule 10(b)(5) may be brought only by persons who ***sold or purchased stock after the date of an alleged misrepresentation*** . . . .") (emphasis added) (*citing Blue Chip Stamps*).[9]

The *Blue Chip Stamps* decision, however, only limits standing to purchasers or sellers of securities in Rule 10b-5 cases. Indeed, the Court reaffirmed that "it has long been established in the ordinary case of deceit that ***a misrepresentation***

[9] The Supreme Court foreclosed another avenue of recovery for investors in *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 126 S.Ct. 1503 (2006). The Court there held that the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") pre-empts state-law holder class-action claims. 547 U.S. at 87, 126 S.Ct. at 1514. Thus, the collective result of the *Blue Chip Stamps* and *Dabit* decisions is that investors may not pursue a federal securities law claim in a holder case, nor a state-law holder class-action claim.

which leads to a refusal to purchase or to sell is actionable in just the same way as a misrepresentation which leads to the consummation of a purchase or sale." 421 U.S. at 744, 95 S.Ct. at 1929 (emphasis added). The Court further noted that the remedies denied by restricting standing to purchasers or sellers "is attenuated to the extent ***that remedies are available to nonpurchasers and nonsellers under state law.***" 421 U.S. at 739, 95 S.Ct. at 1927 (emphasis added). Thus, the *Blue Chip Stamps* decision recognizes that holder claims would continue to be viable under state common law.

In addition to preclusion of holder claims under the federal securities laws, there is no private right of action under Georgia securities law for holder claims because there is no purchase or sale. Under both the Georgia Securities Act of 1973 (effective for actions pending on or before July 1, 2009), as well as the Georgia Uniform Securities Act of 2008 (effective July 1, 2009), the remedies provided are patterned after Section 10(b) and Rule 10b-5, and similarly are available only with respect to acts "in connection with" the sale or purchase of securities. O.C.G.A. §10-5-12(a)(2) (1973 Act) and O.C.G.A. §10-5-50 (2008 Act). Regulations promulgated by the Georgia Securities Commission are to the same effect.[10] A number of other state securities laws ("Blue Sky Laws") similarly provide a right of action only to purchasers or sellers.[11] Thus, investors who are damaged by fraudulent advice to forbear from selling their securities must seek recovery under state common law remedies, a reality a growing number of courts have recognized. *See*, Appendix "B". Indeed, some states that preclude holder claims under applicable state securities acts allow such claims to proceed under common law tort theories. *See, e.g., Small v. Fritz Companies, Inc., supra*;

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[10] Rule 590-4-2-.14(1)(a)(3), entitled *Dishonest or Unethical Business Practices*, authorizes the Securities Commissioner to take action against brokers who: "recommend[] to a customer ***the purchase, sale or exchange of any security*** without reasonable grounds to believe that such transaction or recommendation is suitable for the customer based upon reasonable inquiry concerning the customer's investment objectives, financial situation and needs, and any other relevant information known by the [broker]." (emphasis added).

[11] *See e.g., Small v. Fritz Companies, Inc. supra,* 65 P.3d at 1263 (persons who hold stock in reliance on a misrepresentation have no remedy under Corporations Code section 25000 *et seq.* because its provisions are limited to buyers or sellers of securities); *Kaufman v. Chase Manhattan Bank, N.A.*, 581 F.Supp. 350, 355-56 (S.D.N.Y. 1984) (finding that a plaintiff who neither purchased nor sold on the basis of the alleged misrepresentation could not maintain a claim under New York General Business Law §§ 339-a and 352-c – sections of the "Martin Act".); *In re Enron Corp. Securities, Derivative & "ERISA" Litigation*, 490 F.Supp.2d 784, 802-03 (S.D. Tex. 2007) (the Texas Securities Act, Tex. Rev.Civ. Stat. Art. 581-33 (West 2002) applies to purchases or sales of securities and not to holder claims.) *Rogers v. Cisco Systems, Inc.*, 268 F.Supp.2d 1305, 1311-12 (N.D. Fla. 2003) (concluding that the federal and Florida securities laws only apply to the purchase or sale of securities and not to holder claims.)

Primavera Familienstifung v. Askin, 130 F.Supp.2d 450, 493-95 (S.D.N.Y. 2001) (applying New York law).

Moreover, failing to provide a remedy for holder claims might have the unintended consequences of encouraging those with material information to be less than candid as to the true facts. If investors have no common law claim unless they sell their securities, parties who might otherwise have a duty to disclose truthful material information in their possession will act rationally to avoid liability and keep that information concealed. There is no principled reason to provide any incentive to withhold information critical for an investor to make an informed investment decision. To deny holder claims exonerates those who know, but fraudulently decide not to tell.

The obligation to provide a remedy where there has been a breach of a legal duty has been part of Georgia law for over 140 years. O.C.G.A. § 51-1-6. As O.C.G.A. § 51-6-1 provides, "[f]raud, accompanied by damage to the party defrauded, ***always*** gives a right of action to the injured party." (Emphasis added). Investors who allege that they were fraudulently induced into holding and retaining a security by the direct misrepresentations or omissions of their broker are therefore entitled to seek a remedy for that fraud.

PIABA therefore urges this Court to answer this certified question in the affirmative: the accepted elements of common law fraud, the interests of public policy, and the need to provide a meaningful remedy all point to the propriety of finding that Georgia law recognizes a common law fraud claim based on forbearance in the sale of publicly-traded securities.

II. WITH RESPECT TO A TORT CLAIM BASED ON MISREPRESENTATIONS OR OMISSIONS CONCERNING PUBLICLY-TRADED SECURITIES, PROXIMATE CAUSE IS ADEQUATELY PLED UNDER GEORGIA LAW WHEN A PLAINTIFF ALLEGES THAT HIS INJURY WAS A REASONABLY FORESEEABLE RESULT OF DEFENDANT'S FALSE OR MISLEADING STATEMENTS EVEN THOUGH THE PLAINTIFF DOES NOT ALLEGE THAT THE TRUTH CONCEALED BY THE DEFENDANT ENTERED THE MARKET PLACE, THEREBY PRECIPITATING A DROP IN THE PRICE OF THE SECURITY.

A. No Independent Allegation Of Information Reaching The Marketplace Is Required on These Allegations.

The second certified question before this Court focuses on the factual detail required for a complaint to sufficiently allege proximate cause. PIABA respectfully submits that under well settled principles of Georgia law, the Third Amended Complaint ("TAC"), which alleged that plaintiffs were injured by the reasonably foreseeable consequences of defendants' fraud, negligence, and negligent misrepresentations or omissions directed to plaintiffs and upon which they relied, adequately alleged proximate cause sufficient to survive a motion to dismiss. The substantive detail required respecting causation is not heightened, enlarged or changed because the subject matter of the claim happens to concern publicly traded securities.

Notably, this is ***not*** a case alleging that a "fraud-on-the-market" caused the price of WorldCom to be traded at other than a fair market price, and that damages were suffered when investors relied on the supposed accuracy of marketplace information to buy or sell their shares. *See, e.g., Basic Inc. v. Levinson*, 485 U.S. 224, 108 S. Ct. 978 (1988).[12] Instead, the allegations here are that a fraud was perpetrated upon individual investors, based upon specific communications by defendants to those individual investors: "At all times material, . . . Plaintiffs based their decision to hold their WorldCom stock on false and misleading representations by Defendants." (App. 1879, ¶ 157). As the Second Circuit noted, taking the factual allegations of the complaint as true, "Based on the broker's advice and Grubman's reports, Holmes not only refrained from selling the

[12] As explained by the Supreme Court in *Basic Inc.*, "The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business. . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements." 485 U.S. at 241–42, 108 S. Ct. at 989 (omission in original) (*quoting Peil v. Speiser*, 806 F.2d 1154, 1160 (3d Cir. 1986)).

WorldCom stock, but also purchased additional shares as the price per share declined." Those actions eventually "resulted in losses of nearly $200 million." 568 F.3d at 332.

The allegations of the TAC respecting causation are undoubtedly sufficient under Georgia law. Plaintiffs alleged that reasonably foreseeable financial injury was caused by their justifiable reliance on defendants' misrepresentations:

> "Rather than disclosing this material fact [that WorldCom was not performing as Defendant Grubman had initially forecast] to its clients, including Plaintiffs, the Defendants continued to conceal the true financial strength of WorldCom. ***The Plaintiffs' losses were a materialization of this risk.***"

(App. 1862, ¶ 74, emphasis added). Plaintiffs also alleged that "Defendants owed a duty of care to Plaintiffs as clients and holders of World Com stock who could foreseeably be injured by Defendants' misrepresentations and omissions." (App. 1882, ¶ 168).

Plaintiffs accordingly ***alleged a direct line of causation and damages*** due to Defendants' conduct: The misrepresentations and omissions specifically directed to Plaintiffs, and upon which they directly relied, caused them to hold their existing WorldCom securities, and invest additional monies in WorldCom stock.

Truthful information curing the misrepresentations may or may not ever have entered the market place, and need not have done so to have caused plaintiffs' damages. Indeed, whether or not the truth was eventually disclosed to the market place has no bearing whatsoever on whether a fraud, in fact, occurred as alleged. Plaintiffs' asserted that they relied on defendants, not general information conveyed by the market. A demand that plaintiffs additionally plead that the truth concealed by the defendants entered the market place and caused share prices to fall ignores the specific nature of the fraud alleged, which was that misinformation by the defendant advisors was relied upon by the investor Plaintiffs in making the investment decision to "stay the course."

Dura Pharmaceuticals, Inc. v Broudo, 544 U.S. 336, 125 S. Ct. 1627 (2005), upon which the Federal District Court relied, interpreted the requirements of 15 USC § 78u-4(b)(4) of the Securities Exchange Act of 1934 to require that a plaintiff alleging "fraud-on-the-market" plead "loss causation," since "an inflated purchase price will not itself constitute or proximately cause the relevant economic loss." 544 U.S. at 343. But the claim at issue herein was not brought under the federal securities laws. Nor did the claim assert a "fraud on the market." The claim is simply a common law tort claim under Georgia law alleging misrepresentation.

The proximate cause inquiry for a Georgia tort claimant is whether "the defendant's conduct and the plaintiff's injury are too remote for the law to countenance a recovery." *Atlanta Obstetrics & Gynecology Group, P.A. v. Coleman*, 260 Ga. 569, 569, 398 S.E.2d 16, 16 (1990), *quoting McAuley v. Wills*, 251 Ga. 3, 7, 303 S.E.2d 258, 261 (1983). That determination is based upon "the facts of each case upon mixed considerations of logic, common sense, justice, policy and precedent." *Id.* Tested against that criteria, the TAC was undoubtedly sufficient.

B. The Complaint Sufficiently Pled a Cause of Action Under Georgia Law.

Georgia law places a high bar before a trial court can dismiss a complaint at the outset, before any discovery, based solely on the claimed failure to adequately plead the proximate cause of the injuries sustained. "The decision may be made by the trial judge or appellate court ***only*** if reasonable persons could not differ as to both the relevant facts and the evaluative application of legal standards (such as the legal concept of "foreseeability") to the facts." *Atlanta Obstetrics & Gynecology Group v. Coleman, supra*, 260 Ga. at 570, 398 S.E.2d 16, 18 (emphasis added). Therefore, "[i]t is well settled in Georgia, that '[Q]uestions of . . . proximate cause are peculiarly matters for the jury, and a court should not take the place of the jury in solving them, except in plain and indisputable cases.'" *Williams v. Kennedy*, 240 Ga. 163, 240 S.E.2d 51 (1977), *quoting Bussey v. Dawson*, 224 Ga. 191, 193, 160 S.E.2d 834 (1968).

Assuming the allegations of the TAC to be true, it is "plain and indisputable" that the damages plaintiffs alleged they suffered by holding WorldCom stock, and purchasing more, proximately ***could have*** been caused by the fraud, negligence, and negligent misrepresentations or omissions of defendants upon which plaintiffs relied. It is self evident that if plaintiffs relied upon alleged material misrepresentations and omissions regarding the true financial condition of WorldCom in making their investment decisions, there is a set of facts upon which a jury could conclude that those fraudulent acts were the cause of plaintiffs' economic damages. Logic and common sense naturally suggest that had the truth been known, plaintiffs would have made other and different decisions on where and how to invest their capital, thus avoiding or mitigating the damages suffered. The causal connection on the facts pled is apparent. Plaintiffs should be given the opportunity to prove their case to the trier of fact.

The Federal District Court's imposition of the more rigorous pleading standards required by federal securities statutes upon Georgia common law tort claims created a hurdle completely at odds with well-settled Georgia jurisprudence.

If there is to be a more rigorous proximate cause pleading requirement demanded only for those asserting tort claims involving publicly trades securities, it is for the General Assembly to set forth those requirements, not the judiciary.[13]

The second certified question should therefore be answered in the affirmative: with respect to a tort claim based on misrepresentations or omissions concerning publicly-traded securities, proximate cause is adequately pled under Georgia law when a plaintiff alleges that defendant's false or misleading statements caused injuries that were foreseeable and a "materialization" of the risk posed to investors by the misinformation.

III. UNDER GEORGIA LAW, A BROKERAGE FIRM OWES A FIDUCIARY DUTY TO THE HOLDER OF A NON-DISCRETIONARY ACCOUNT.

A. The Duties and Responsibilities Owed by a Brokerage Firm to Clients Holding Non-Discretionary Accounts Render the Firm a Fiduciary.

The essence of the broker/client relationship is that of principal (customer) and agent (brokerage firm). "The relation of principal and agent arises wherever one person, expressly or by implication, authorizes another to act for him or

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[13] *See, e.g.*, O.C.G.A. § 9-11-9.1, in which the General Assembly required that an affidavit must accompany a complaint of professional malpractice which "set[s] forth specifically at least one negligent act or omission claimed to exist and the factual basis for each such claim."

subsequently ratifies the acts of another in his behalf." O.C.G.A. §10-6-1. "The relationship of principal and agent . . . demands of the agent the utmost loyalty and good faith to his principal." *Koch v. Cochran*, 251 Ga. 559, 560, 307 S.E.2d 918, 919 (1983). There can be no serious dispute that the laws of agency impose those same duties upon a securities broker. Our Court of Appeals has observed that in the broker/client relationship, "[r]equirements of good faith demand that in the principal's interest it is the agent's duty to make known to the principal all material facts which concern the transactions and subject matter of his agency." *Minor v. E. F. Hutton & Co.*, 200 Ga. App. 645, 646, 409 S.E.2d 262, 264 (1991). See also, *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 314, 105 S. Ct. 2622, 2630 (1985) (a broker-dealer "owes a duty of honesty and fair dealing toward his clients.").

A non-discretionary account requires a brokerage firm to obtain a client's authorization before undertaking any investment transactions. *Glisson v. Freeman*, 243 Ga. App. 92, 99, 532 S.E. 2d 442, 449 (2000). But the obligations of a broker handling a non-discretionary account are more than simply being an "order taker" who competently executes a securities transaction. The duties required in handling a non-discretionary account include:

> the duty to recommend a stock only after studying it sufficiently to become informed as to its nature, price and financial prognosis; (2) the duty to carry out the customer's orders promptly in a manner best suited to serve the customer's interests; (3) the duty to inform the customer of the risks involved in purchasing or selling a particular security; (4) the duty to refrain from self-dealing or refusing to disclose any personal interest the broker may have in a particular recommended security; (5) the duty not to misrepresent any fact material to the transaction; and (6) the duty to transact business only after receiving prior authorization from the customer.

Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 461 F. Supp. 951, 953 (E.D. Mich. 1978) (citations omitted), *affirmed*, 647 F.2d 165 (6th Cir. 1981). *See also*, *Glisson*, *supra*, 243 Ga. App. at 99, 532 S.E. 2d at 449 ("With respect to a nondiscretionary account . . . the broker owes a number of duties to the client, including the duty to transact business only after receiving prior authorization from the client and the duty not to misrepresent any fact material to the transaction."); *Merrill Lynch Pierce Fenner & Smith, Inc. v. Cheng*, 901 F.2d 1124, 1128 (D.C. Cir. 1990) (basic agency law establishes fiduciary duties in non-discretionary accounts, including duties (1) not to make unauthorized trades, (2) to inform client of right to reject unauthorized trades, and (3) generally, to disclose "information which is relevant to affairs entrusted to him of which he has notice."); *Gochnauer* *v. A.G. Edwards & Sons, Inc.*, 810 F.2d 1042, 1049 (11th Cir. 1987) (*citing Leib* with approval as to the duties of broker in a nondiscretionary account).[14]

The particularized duties undertaken by a broker handling a non-discretionary account – such as the duty to recommend an investment only after sufficient investigation of the investment, the duty to avoid self-dealing, and the duty to inform the customer of the risks of an investment -- impose upon the broker a higher duty of care than would otherwise be found in the garden variety agent/principal relationship. *See, e.g., Opper v. Hancock Sec. Corp.*, 250 F.Supp. 668, 676 (S.D.N.Y. 1966), *aff'd*, 367 F.2d 157 (2d Cir. 1966) (the duties of a securities broker "are, if anything, more stringent than those imposed by general agency law.").

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[14] These duties are mirrored in Rule 2310(a) of the Financial Industry Regulatory Authority ("FINRA"), the largest independent regulator for all securities firms doing business in the United States. Known as the "Know Your Customer" or "Suitability" Rule, it provides that, "[i]n recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs." Material to the first certified question herein, NYSE Rule 472.10 /09 defines a recommendation as "any advice suggestion or other statement, written or oral, that is intended, or can reasonably be expected, to influence a customer to purchase, sell, ***or hold*** a security." (Emphasis added).

As a result, a securities broker is required to adhere to a standard of more than ordinary care in its handling of a client's account. The broker is judged against the standard of prudence and care expected of a trained and experienced financial professional:

> [I]t is normally not sufficient for a broker to exercise ordinary care and judgment in discharging his duties, he must employ such care, skill, prudence, diligence and judgment as might reasonably be expected of persons skilled in his calling. If his customer's money is lost because the broker undertakes his duties without possessing the requisite skills, or because of his negligence, the broker is liable for the loss.

Poser, Broker-Dealer Law & Regulation, § 2.03[A][1] (2002 Supp).

That the law should hold a securities broker to a higher standard of care comes as no surprise. Brokerage firms spend millions of dollars to convince the public that their advisors are not mere "order takers" mechanically executing buy and sell orders. Rather, brokerage firms aggressively market themselves as skilled advisors competent to handle every aspect of their clients' financial life, from investments to mortgages, life insurance, long-term care, estate planning, and charitable giving.[15] Studies in behavioral finance demonstrate that securities

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[15] For example, the web site of Morgan Stanley Smith Barney, LLC, an investment adviser and broker-dealer affiliated with Appellee Citigroup Global Markets, Inc., proclaims that its brokers "can create personal investment strategies to help you meet your retirement, education, wealth transfer and other financial

brokers are highly motivated to cultivate their clients' trust and allegiance, and clients have powerful incentives to believe that such advisors are trustworthy and acting solely in the client's best interests. Langevoort, *Selling Hope, Selling Risk: Some Lessons for Law from Behavioral Economics about Stockbrokers and Sophisticated Customers*, 84 Calif. L. Rev. 627 (May 1996). Obtaining a client's trust and confidence, and convincing the client that he or she should rely upon the investment advice given, is at the heart of the broker/client relationship.

It therefore is no surprise that investors believe that their stock brokers owe them a fiduciary duty. Recent studies have found that more than 60 percent of investors believed that brokers have a fiduciary duty. See, e.g., Investor and Industry Perspectives on Investment Advisers and Broker-Dealers, p. 31, RAND Institute for Civil Justice (2008) (commissioned by the U.S. Securities and Exchange Commission) (citing 2006 survey of 1,000 investors by TD Ameritrade).

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needs. . . . With all of today's noise and uncertainty, people need the right financial advice and resources. . . . Equipped for advanced financial planning, our Financial Advisors are ready to draw on experts in taxes, insurance, estate planning and more. . . . Our clients have entrusted us with $1.3 trillion [as of June 2009] of their hard-earned assets. Morgan Stanley Smith Barney is dedicated to bringing you the help you deserve, at a time when you need it most." http://www.morganstanleysmithbarney.com/aboutus.html. (Last visited September 17, 2009). In contrast, those who do not need or desire such counsel and assistance can use anyone of a number of "discount brokers" that simply act as the order-taker for the customer's transactions, and do not offer any advice.

In this case, Appellants' pleadings allege that they, too, placed significant trust and reliance on the broker's supposed expertise, advice, and recommendations. (Appellants' Brief pp. 3, 21).

Because the brokerage firm/customer relationship, whether discretionary or non-discretionary, is based upon the client's inducement to rely upon the perceived special knowledge of the broker, the relationship is one which Georgia law codifies as a "confidential relationship" requiring the exercise of the "utmost good faith" by the principal – one of the primary touchstones of the existence of a fiduciary duty:

> Any relationship shall be deemed confidential, whether arising from nature, created by law, or resulting from contracts, where one party is so situated as to exercise a controlling influence over the will, conduct, and interest of another or where, from a similar relationship of mutual confidence, the law requires the utmost good faith, such as the relationship between partners, principal and agent, etc.

O.C.G.A. § 23-2-58.

The ***extent*** of the broker's fiduciary duty may vary under differing factual circumstances, but the ***existence*** of the duty – arising from the client's reliance on the broker's special expertise -- cannot reasonably be questioned. *In re Merrill Lynch Sec. Litig.*, 911 F.Supp. 754, 768 (D.N.J. 1995) ("The fiduciary duty is fundamental to the broker/client relationship.") *rev'd on other grounds*, 135 F.3d 266 (3rd Cir. 1998). The broker's fiduciary duty is undoubtedly at its peak when the client grants discretion to buy or sell securities without getting the client's consent before each trade. *See, e.g., Indep. Order of Foresters v. Donald, Lufkin & Jenrette, Inc.*, 157 F.3d 933, 940-41 (2d Cir. 1998) (noting that typically a broker operating a discretionary account has a general fiduciary duty to his client whereas a broker operating a non-discretionary account has narrower obligations). But the client's entry into a non-discretionary investment account does not vitiate those fiduciary duties, since an agent whose role is to make, manage or advise on investments owes fiduciary duties to his/her agent. *Restatement (Second) Agency* § 425 (agents employed to make, manage or advise on investments have a fiduciary duty). *See also*, Weiss, *A Review of the Historic Foundations of Broker-Dealer Liability for Breach of Fiduciary Duty*, 23 Iowa Journal of Corporate Law 65 (1997); *Gochnauer, supra*, 810 F.2d at 1049 ("The law is clear that a broker owes a fiduciary duty of care to a securities investor."); *Rolf v. Blyth, Eastman, Dillon & Co.*, 570 F.2d 38 (2d Cir. 1978). The courts of at least 22 states have similarly concluded that a securities broker stands in a fiduciary relationship with the investor/client. *See* Appendix "C".

Our own Court of Appeals has therefore consistently and correctly held – without the need to draw a distinction between discretionary and non-discretionary accounts -- that "a stockbroker's duty to account to its customer is fiduciary in nature, so that the broker is obligated to exercise the utmost good faith." *Glisson, supra*, 243 Ga. at 99, 532 S.E. 2d at 449, *quoting Minor v. E. F. Hutton & Co.*, 200 Ga. App. 645, 647, 409 S.E.2d 262 (1991) (citations and punctuation omitted); *E. F. Hutton & Co. v. Weeks*, 166 Ga. App. 443, 445, 304 S.E.2d 420, 422 (1982) (same); *see also, Tigner v. Shearson-Lehman Hutton, Inc.*, 201 Ga. App. 713, 411 S.E.2d 800 (1991) (finding of fiduciary relationship where broker exercised a "controlling influence" over the customer and the customer relied on the relationship).

For decades, the federal securities laws and regulatory scheme, as well as the "Blue Sky" laws and regulations of a number of states, have rejected the concept of *caveat emptor* as it applies to securities transactions. Instead, as a matter of public policy, the rule is "Let the Seller Beware." Indeed, under Georgia's current and former legislative scheme, it is the ***seller*** who has the burden of proof to show that they did not know, and in the exercise of reasonable care could not have known, of material misstatements or omissions made in connection with the sale of securities. O.C.G.A. § 10-5-14(a)(2) (1973 Securities Act); O.C.G.A. § 10-5-58(b) (2008 Securities Act).

In the words of the United States Supreme Court, the "fundamental purpose [of the securities laws is] . . . to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry." *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186, 84 S. Ct. 275, 280 (1963). *See also, Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151, 92 S.Ct. 1456, 1472 (1972). Full and truthful disclosure, a rejection of caveat emptor, and adherence to high ethical standards aptly describe the core responsibilities of a fiduciary.

In sum, the law of agency as applied to the special and distinct role of a securities broker in securing the trust and confidence of its clients – whether in a discretionary or non-discretionary account – renders the broker a fiduciary.

B. Regulatory Authorities Recognize That a Securities Broker Owes a Higher Duty to Its Clients.

Under the so-called "Shingle Theory" of liability developed from the law of agency by the Securities & Exchange Commission ("SEC"), a broker who solicits and accepts orders from the public implicitly represents that he will deal fairly with his customers. *Charles Hughes & Co. v. SEC*, 139 F.2d 434 (2d Cir. 1943); *Kahn v. SEC*, 297 F.2d 112, 115 (2d Cir. 1961). According to the SEC, it is a "basic principle" that by holding itself out to the public as a broker-dealer, a firm represents that it will act in the customer's best interest. *In re D.E. Wine Investments, Inc.*, Admin. Proceeding File No. 3-8543 Release No. ID-134, 1999

WL 373279 (June 9, 1999). The SEC has therefore concluded that the law of agency, coupled with the rules of the self-regulatory agencies such as FINRA, also give rise to a fiduciary duty owed by brokers. *See, e.g., In re E.F. Hutton & Co.*, Exchange Act Release No. 25,887 [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,303 (July 6, 1988).

As noted, FINRA Conduct Rules impose upon a brokerage firm and its members the obligation to make only suitable investment recommendations to their clients after learning the essential facts concerning those clients.[16] Recognizing that the broker/investor relationship is fundamentally different from a garden variety consumer relationship, the Conduct Rules of the FINRA also require that its member firms -- for both discretionary and non-discretionary accounts -- "shall observe high standards of commercial honor and just and equitable principles of trade." FINRA Conduct Rule 2110.[17] Given the public policy rationale of the securities laws, it is no surprise that the regulations governing the broker/client relationship impose upon the broker some of the very same criteria that Georgia

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[16] *See* fn. 14 *supra.*

[17] Former New York Stock Exchange Rule 401 required a similar high standard of business practices: "Every member, allied member and member organization shall at all times adhere to the principals of good practice in the conduct of his or its business affairs."

law looks to when concluding that a fiduciary relationship exists between a principal and its agent. *See*, O.C.G.A. 23-2-58, *supra*.

Indeed, both the current Chairwoman, as well as the past two Chairmen of the SEC, have recognized that brokerage firms act in a fiduciary role with respect to their clients. For example, Harvey L. Pitt, Chairman from 2001 to 2003, observed that "Regulation can never substitute for people doing their jobs honestly, dedicated to serving their customers *as the fiduciaries they are*."[18] During the recent "credit crisis," Chairman Christopher Cox affirmed that "[n]ow more than ever, companies need to take a long-term view on compliance and realize that *their fiduciary responsibility requires a constant commitment to investors*."[19] Within the last few months, the current Chairwoman, Mary Shapiro, testified before Congress that "*all* financial service providers that provide personalized investment advice about securities *should owe a fiduciary duty to their customers or clients*."[20]

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[18] Securities Industry Association (SIA) Annual Meeting, November 8, 2002, http://archives2.sifma.org/speeches/html/pitt02.html (emphasis added).

[19] Address to the 2008 Outreach National Seminar, November 13, 2008 http://www.sec.gov/news/speech/2008/spch111308cc.htm (emphasis added).

[20] Testimony Concerning SEC Oversight: Current State and Agenda, United States House of Representatives Committee on Financial Services Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises (July 14, 2009) (emphasis added).

Accordingly, PIABA urges this Court to answer this certified question in the affirmative: the law of agency, public policy, the laws and regulatory structure of our nation's securities scheme, and the common sense reality that clients accept their brokers' invitation and encouragement to trust them regarding investment decisions, all confirm that a brokerage firm owes a fiduciary duty to the holder of a non-discretionary account.

This 23rd day of September, 2009.

Respectfully submitted,

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APPENDIX "A"

The following list is exemplary. To the extent that a state has applied Restatement §552 in the context of investment advice or securities firms, that case is cited here; if no such case exists in that state, a leading case from that state was chosen, and the business involved is provided in parentheses.

Alabama: *Boykin v. Arthur Andersen & Co.*, 639 So. 2d 504 (Ala. 1994) (accountants);

Alaska: *Willard v. Khotol Services Corp.*, 171 P.3d 108 (Al. 2007) (employer);

Arizona: *Standard Chartered PLC v. Price Waterhouse*, 945 P.2d 317 (Az. Ct. App. 1996), as corrected on denial of reconsideration, (Jan. 13, 1997) (accountants);

California: *OCM Principal Opportunities Fund v. CIBC World Markets Corp.*, 157 Cal. App. 4th 835, 68 Cal. Rptr. 3d 828 (Cal. App. 2007);

Colorado: *Ebrahimi v. E.F. Hutton & Co., Inc.*, 794 P.2d 1015 (Co. Ct. App. 1989) (broker-dealer);

Connecticut: *Mason v. Burkett,* 756 F.Supp. 679 (D. Conn. 1991) (financial planner);

Delaware: *Guardian Construction Co. v. Tetra Tech Richardson,* 583 A.2d 1378 (Del. Super. 1990) (design engineer);

Florida: *Maliner v. Wachovia Bank, N.A.*, 2005 U.S. Dist. LEXIS 5985 (S.D. Fla. 2005) (securities brokers and financial planners);

Georgia: *Badische Corp. v. Caylor*, 257 Ga. 131, 356 S.E.2d 198 (1987) (accountant);

Hawaii: *Chun v. Park*, 462 P.2d 905 (Ha. 1969) (title company);

Illinois: *Zahorik v. Smith Barney Harris Upham Co., Inc.*, 664 F. Supp. 309 (N.D. Ill. 1987) (broker-dealer);

Iowa: *Northeast Iowa Ethanol L.L.C. v. Drizin,* 2006 WL 290517 (N.D. Iowa 2006) (purported investment broker at company holding escrow funds);

Kansas: *Mahler v. Keenan Real Estate, Inc.*, 876 P.2d 609 (Kan. 1994) (real estate brokers);

Kentucky: *Presnell Construction Managers, Inc. v. EH Construction, LLC*, 134 S.W.3d 575 (Ky. 2004) (construction firm);

Louisiana: *First Nat. Bank of Commerce v. Monco Agency Inc.*, 911 F.2d 1053 (5th Cir. 1990) (accounting firm);

Maine: *Bowers v. Allied Inv. Corp.*, 822 F. Supp. 835 (D. Me. 1993) (accounting firm);

Massachusetts: *Nycal Corp. v. KPMG Peat Marwick LLP.*, 688 N.E.2d 1368 (Mass. 1998) (accountant);

Michigan: *Molecular Technology Corp. v. Valentine*, 925 F.2d 910 (6th Cir. 1991) (corporate officer and directors, broker and salesman of securities and attorney and law firm);

Minnesota: *Stephenson v. Deutsche Bank AG*, 282 F. Supp.2d 1032 (D. Minn. 2003) (bank and securities broker-dealers);

Mississippi: *Hosford v. McKissack*, 589 So.2d 108 (Miss. 1991) (pest control operator and employee);

Missouri: *Mark Twain Plaza Bank v. Lowell H. Listrom & Co., Inc.*, 714 S.W.2d 859 (Mo. Ct. App. W.D. 1986) (securities broker-dealer);

Montana: *Brown v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 197 Mont. 1, 640 P.2d 453 (1982) (broker-dealer and agents);

Nebraska: *Washington Mut. Bank v. Advanced Clearing, Inc.*, 267 Neb. 951, 679 N.W.2d 207 (2004) (brokerage firm);

Nevada: *Goodrich & Pennington Mortg. Fund, Inc. v. J.R. Woolard, Inc.*, 120 Nev. 777, 101 P.3d 792 (2004) (real estate appraiser);

New Hampshire: *Spherex, Inc. v. Alexander Grant & Co.*, 451 A.2d 1308 (N.H. 1982) (accountant);

New Jersey: *SEC v. Hughes Capital Corp.*, 124 F.3d 449 (3rd Cir. 1997) (individuals involved in fraudulent stock scheme);

New Mexico: *Gouveia v. Citigroup Person-to-Person Financial Center, Inc.*, 101 N.M. 572, 686 P.2d 262 (1984) (real estate broker);

North Carolina: *Raritan River Steel Co. v. Cherry, Bekaert & Holland*, 367 S.E.2d 609 (N.C. 1988) (accountants);

Ohio: *Haddon View Inv. Co. v. Coopers & Lybrand*, 436 N.E.2d 212 (Sup. Ct. Ohio 1982) (accountant);

Oklahoma: *Commercial Financial Services, Inc. v. Arthur Andersen LLP* 94 P.3d 106 (Ok. Civ. App. 2004) (credit rating agency);

Oregon: *Conway v. Pacific University*, 924 P.2d 818 (Ore. 1996) (employer);

Pennsylvania: *Gibbs v. Ernst*, 647 A.2d 882 (Pa. 1994) (private child placement and state adoption agencies);

Rhode Island: *Dowling v. Narrangansett Capital Corp.*, 735 F. Supp. 1105 (D.R.I. 1990) (corporation and its directors, officers and certain shareholders and investment banking firm);

South Carolina: *ML-Lee Acquisition Fund, L.P. v. Deloitte & Touche*, 489 S.E.2d 470 (S.C. 1997) (accounting firm);

South Dakota: *Bayer v. PAL Newcomb Partners*, 643 N.W.2d 409 (S.D. 2002) (real estate developer);

Tennessee: *Bethlehem Steel Corp. v. Ernst & Whinney*, 822 S.W.2d 592 (Tenn. 1991) (accounting firm);

Texas: *Lutheran Brotherhood v. Kidder Peabody & Co., Inc.*, 829 S.W.2d 300 (Tx. Ct. App. 1992) (securities broker-dealer);

Utah: *Marchese v. Nelson*, 809 F. Supp. 880 (D. Utah 1993) (securities broker and broker-dealer);

Vermont: *McGee v. Vermont Fed. Bank, FSB*, 726 A.2d 42, 44 (Vt. 1999) (insurance);

Virginia: *Waterside Capital Corp. v. Hales, Bradford & Allen, LLP*, 2007 WL 2254661 (E.D.Va. 2007) (accountants) (Virginia sometimes calls the tort "constructive fraud");

Washington: *Haberman v. Wash. Pub. Power Supply Sys.*, 109 Wn.2d 107, 744 P.2d 1032 (1987) (accountants, investment advisor firm and officers, engineers and attorneys);

Washington, DC: *Remekis v. Boss & Phelps, Inc.*, 419 A.2d 986 (D.C. Ct. App. 1980) (real estate agent and termite inspection company);

West Virginia: *First Nat. Bank of Bluefield v. Crawford*, 182 W.Va. 107, 386 S.E.2d 310 (1989) (accountant);

Wyoming: *Richey v. Patrick*, 904 P.2d 798 (Wy. 1995).

Cf. Indiana (*Trytko v. Hubbell, Inc.*, 28 F.3d 715 (7th Cir. 1994) (limiting use of § 552 to the employment relationship and declining to extend to negligent professional advice); Wisconsin (*Hatleberg v. Norwest Bank Wisconsin*, 282 Wis.2d 234, 700 N.W.2d 15 (2005) (utilizing the elements of the Restatement in a claim against a bank without explicitly applying § 552). *But see South County, Inc. v. First Western Loan Co.*, 871 S.W.2d 325, 326 (Ark. 1994) (declining to adopt the tort of negligent misrepresentation)."[21]

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[21] Lipner and Catalano, *The Tort of Giving Negligent Investment Advice*, 39 U. Mem. L.Rev. 663, 680 n. 76 (2009).

APPENDIX "B"

State and federal courts which have found that investors who refrained from selling their securities based on a fraudulent representation may maintain a common law fraud claim:

California: *Small v. Fritz Companies, Inc.*, 65 P.3d 1255, 1259, (Cal. 2003) (The Supreme Court of California held that investors who were wrongfully induced to hold their stock rather than selling based on fraudulent reports could maintain a common law fraud claim where there was a bona fide showing of actual reliance upon the misrepresentations. The court explained that "California law has long recognized the principle that induced forbearance can be the basis for tort liability [and although] California has not yet applied this principle to lawsuits involving misrepresentations affecting corporate stock . . . we should not make an exception for such cases. Most other states that have confronted this issue have concluded that forbearance from selling stock was sufficient reliance to state a cause of action.")

Delaware: *In re Countrywide Corporation Shareholders Litigation*, 2009 WL 846019 (Del.Ch. 2009) (relying on *Continental Insurance Co. v. Mercadante,* 222 A.D. 181, 184, 225 N.Y.S. 488 (N.Y. App. Div. 1st Dep't 1928), the court concluded that common law fraud holder claims are viable.)

Florida: *Rogers v. Cisco Systems, Inc.*, 268 F.Supp.2d 1305, 1313-14 (N.D. Fla. 2003) (relying on *Restatement (Second) Torts* § 525 (1977) and other Florida district court decisions, the court held that Florida courts would recognize a cause of action for fraud for holding claims. The court dismissed the claim and granted leave to amend, however, because the allegations to satisfy the reliance requirement were too vague.)

Massachusetts: *Fottler v. Moseley*, 179 Mass. 295, 299-300, 60 N.E. 788, 789 (1901) (holding that if a stockholder was induced to cancel his sell order based on defendant's misrepresentations, a cause of action for fraud may be maintained); *David v. Belmont*, 291 Mass. 450, 452-53, 197 N.E. 83, 84 (1935) (discussing the proper measure of damages in investor's action for fraud which induced him to retain stock he otherwise would have sold); *Reisman v. KPMG Peat Marwick LLP*, 57 Mass.App.Ct. 100, 112, 787 N.E.2d 1060, 1068-69 (2003) (concluding that it has long been established under Massachusetts law that a claim for fraud may be established where a fraudulent misrepresentation led to the decision to purchase and/or retain stock.)

New Jersey: *Duffy v. Smith*, 32 A. 371, 372 (N.J. 1895) (plaintiff who was fraudulently induced to buy stock could recover damages for the period he retained the stock based on the same representation that induced the purchase); *Gutman v. Howard Savings Bank*, 748 F. Supp. 254, 264 (D.N.J. 1990) (permitting an investor's common law fraud claim predicated on the investor's retention of their stock based on oral and written misrepresentations, predicting that New Jersey would apply "the general rule that inaction induced by a misrepresentation establishes the reliance element in a fraud claim." *Relying on Restatement (First) and Restatement (Second) of Torts* § 525.)

New York: *Continental Insurance Co. v. Mercadante*, 222 A.D. 181, 184, 225 N.Y.S. 488 (N.Y. App. Div. 1st Dep't 1928) (bondholders who retained their bonds based on false representations concerning the earnings and solvency of the obligor could maintain a common law fraud claim. "When an act produces conduct from which flows injury, it cannot matter whether that conduct be affirmative or negative, active or quiescent . . . [w]e conclude, therefore, that plaintiffs cannot be denied redress because their conduct was inaction rather than action."); *Marbury Management, Inc. v. Kohn*, 629 F.2d 705 (2d Cir. 1980) (upholding judgment awarding damages to an investor who sustained losses when he retained his stock in reliance on false representations made by his broker); *Kaufman v. Chase Manhattan Bank*, 581 F.Supp. 350, 354 (S.D.N.Y. 1984) (the court found that an investor in a corporation could establish proximate cause and, thus, maintain a fraud cause of action where his purchase and retention were based on misstatements and omissions); *Gutman v. Howard Savings Bank*, 748 F.Supp. 254, 262-63 (D.N.J. 1990) (permitting an investor's common law fraud claim predicated on the investor's retention of their stock based on oral and written misrepresentations, reasoning that it did not believe that the New York Court of Appeals would overrule *Mercadante* if faced with the issue); *ABF Capital Management v. Askin Capital Management, L.P.*, 957 F.Supp. 1308, 1325 (S.D.N.Y. 1997) (investors in hedge funds stated a claim for fraud when they were alleged to have retained their investments based on written misstatements by the hedge fund managers); *AUSA Life Ins. Co. v. Ernst & Young*, 206 F.3d 202, 220 (2d Cir. 2000) (relying on *Mercadante*, the court held that holders of privately-placed debt securities may state a claim for "actionable deceit"); *Primavera Familienstifung v. Askin*, 130 F.Supp.2d 450, 493-95 (S.D.N.Y. 2001) (investors may assert a common law fraud claim based on misrepresentations that induced them to purchase and/or retain securities); *In re Worldcom, Inc. Securities Litigation*, 382 F.Supp.2d 549, 559-60 (S.D.N.Y. 2005) (finding that New York recognizes a claim for fraud where investors retain their securities based on the defendant's misrepresentation, but imposing the additional requirement that there must have been direct communication between the investors and defendants); *Goldin v. Salomon Smith Barney*, 994 So.2d 517, 520 (3rd D.C. Fla. 2008) (interpreting New York law and also imposing a "direct communication" requirement); *cf, Pension Committee of the University of Montreal Pension Plan v. Bank of America Securities, LLC*, 446 F.Supp.2d 163 (S.D.N.Y. 2006) (disagreeing with defendant's contention that holder claims may only be brought where the representations were made through "direct face-to-face communications". The court distinguished *In re Worldcom, Inc. Securities Litigation,* explaining that the claim was dismissed because plaintiffs failed to allege *any* direct communication, whether written or oral, and further explained that written misstatements by defendants were held to be sufficiently direct to support holder claims, citing to *AUSA Life Ins. Co. v. Ernst & Young*, 206 F.2d 202, 212-13 (2d Cir. 2000)).

Utah: *Marchese v. Nelson,* 809 F. Supp. 880, 890-92 (D. Utah 1993) (recognizing the viability of common law fraud and negligent misrepresentation claims in the holder context.)

Virginia: *Arlund v. Deloitte & Touche LLP*, 199 F.Supp.2d 461, 489-90 (E.D.Va. 2002) (recognizing that retaining shareholders may maintain a common law fraud claim, but dismissing the claim because plaintiffs failed to allege "causation between the misrepresentation and the harm" or loss causation.)

APPENDIX "C"

The courts of at least 22 states have concluded that a securities broker stands in a fiduciary relationship with the investor/client.

Alabama: *Chipser v. Kohlmeyer & Co.*, 600 F.2d 1061, 1066-1067 (5th Cir. 1979);

Arizona: *SEC v. Rauscher Pierce Refsnes, Inc.*, 17 F. Supp. 2d 985, 992-993 (D. Ariz. 1998);

California: *Duffy v. Cavalier*, 215 Cal. App. 3d 1517, 1529 (Cal. App. 1st Dist. 1989);

Colorado: *Rupert v. Clayton Brokerage Co.*, 737 P.2d 1106, 1109 (Colo. 1987);

Delaware: *O'Malley v. Boris*, 742 A.2d 845, 849 (Del. 1999);

Florida: *First Union Brokerage v. Milos*, 717 F. Supp. 1519, 1526 (S.D. Fla. 1989) ("Different fiduciary duties are owed based on whether the account is discretionary or nondiscretionary.");

Illinois: *Martin v. Heinold Commodities*, 643 N.E.2d 734, 738 (Ill. 1994);

Iowa: *Cunningham v. PFL Life Ins. Co.*, 42 F. Supp. 2d 872, 888-889 (N.D. Iowa 1999);

Kansas: *Denison State Bank v. Madeira*, 640 P.2d 1235, 1241 (Kan. 1982);

Louisiana: *Beckstrom v. Parnell*, 730 So. 2d 942, 948-949 (La. 1998);

Maryland: *Kaufman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 464 F. Supp. 528, 536 (D. Md. 1978);

Minnesota: *McGinn v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 736 F.2d 1254, 1258 (8th Cir. 1984);

Mississippi: *Puckett v. Rufenacht, Bromagen & Hertz, Inc.*, 587 So. 2d 273, 279 (Miss. 1991);

Montana: *Vogel v. A.G. Edwards & Sons, Inc.*, 801 S.W.2d 746, 752 (Mo. Ct. App. 1990) ("Where the account is non-discretionary and the customer rather than the broker makes the decision which stocks to buy and sell, the stockbroker's duties are somewhat limited. They are, nonetheless, fiduciary duties.");

New Mexico: *Reinhart v. Rauscher Pierce Sec. Corp.*, 83 N.M. 194, 199 (N.M. Ct. App. 1971);

New York: *Press v. Chemical Inv. Servs. Corp.*, 166 F.3d 529, 536 (2d Cir. N.Y. 1999) ("...the fiduciary obligation that arises between a broker and a customer as a matter of New York common law is limited to matters relevant to affairs entrusted to the broker.");

Ohio: *Thropp v. Bache Halsey Stuart Shields, Inc.*, 650 F.2d 817, 821 (6th Cir. Ohio 1981);

South Dakota: *Dinsmore v. Piper Jaffray, Inc.*, 593 N.W.2d 41, 46 (S.D. 1999);

Texas: *Tapia v. Chase Manhattan Bank, N.A.*, 149 F.3d 404, 412 (5th Cir. 1998);

Utah: *Marchese v. Nelson*, 809 F. Supp. 880, 894 (D. Utah 1993) ("...the existence of a fiduciary relationship cannot be based merely on whether the customer's account is discretionary or nondiscretionary.");

Vermont: *Jarvis v. Dean Witter Reynolds, Inc.*, 614 F. Supp. 1146, 1150 (D. Vt. 1985);

West Virginia: *Baker v. Wheat First Sec.*, 643 F. Supp. 1420, 1428 (S.D. W. Va. 1986) ("The Court does not believe that the discretionary - non-discretionary dichotomy is the shibboleth which [the broker] attempts to make it out to be.").

CERTIFICATE OF SERVICE

THIS IS TO CERTIFY that I have this day served a copy of "AMICUS CURIAE BRIEF OF PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION" upon the following, by causing same to be placed in the United States Mail with adequate first-class postage affixed thereon, addressed as follows:

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This 23rd day of September, 2009.

Respectfully submitted,

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