# In the
# Supreme Court of Ohio

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| WILLIAM LaWARRE, et al. | : | Supreme Court Case No. |
| | : | |
| Appellants, | : | |
| | : | On Appeal from the |
| vs. | : | Hamilton County Court of Appeals, |
| | : | First Appellate District |
| FIFTH THIRD SECURITIES, INC., et al. | : | |
| | : | |
| Appellees. | : | Court of Appeals |
| | : | Case No.: C1100302 |
| | : | |

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**MEMORANDUM OF AMICUS CURIAE, PUBLIC INVESTOR ARBITRATION BAR ASSOCIATION, IN SUPPORT OF JURISDICTION**

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## I. STATEMENT OF INTEREST OF AMICUS CURIAE AND EXPLANATION OF WHY THIS CASE IS A CASE OF PUBLIC OR GREAT GENERAL INTEREST

### A. STATEMENT OF INTEREST OF AMICUS CURIAE

The Public Investors Arbitration Bar Association (PIABA) is a national bar association established in 1990 as an educational and networking organization for attorneys representing the public investor in securities disputes. PIABA's members are involved in promoting the interests of the public investor in securities and commodities arbitration. The mission of PIABA is to promote the interests of the public investor in securities and commodities arbitration by protecting public investors from abuses in the arbitration process, such as those associated with document production and discovery; making securities and commodities arbitration as just and fair as systematically possible; and creating a level playing field for the public investor in securities and commodities arbitration.

PIABA has particular interest in this litigation because the remedial purposes of the Ohio Blue Sky Laws, which were drafted broadly to protect the investing public "from its own imprudence as well as the chicanery of unscrupulous securities dealers," *In re Columbus Skyline Securities, Inc*., 74 Ohio St.3d 495, 498, 660 N.E.2d 427 (1996), may be significantly and adversely affected by the ruling in the case at bar.

### B. EXPLANATION OF WHY THIS CASE IS A CASE OF PUBLIC OR GREAT INTEREST

This Court should exercise jurisdiction in this case because the Appellate Court's ruling is directly at odds with established law regarding the duties owed by broker-dealer firms to their customers, and if allowed to stand, will significantly reduce protections to Ohio investors. A reversal by this Court will clarify the duties owed by securities broker-dealer firms to their customers when such firms become aware of misconduct that may result in financial harm.

Encompassing 2,408 licensed broker-dealers and over 133,000 investment salespersons, the Ohio investment securities industry plays a vital role in the state's economy and the financial security of hundreds of thousands of Ohio investors.[1]

Securities broker-dealers nationwide generate over $263 billion in revenue each year, underscoring the importance of providing and properly applying laws and regulations in order to protect this tremendous trove of investor wealth.[2] Given the economic importance of the purchase and sale of securities, countering the threat of investment securities fraud and safeguarding the sacrosanct trust investors place in advisers and broker-dealers is of unparalleled public interest.

Such fraud has drawn the attention of civil and criminal authorities. The Financial Industry Regulatory Authority (FINRA) processed 1,287 cases of finance-related fraud in 2011[3], while the Federal Bureau of Investigation (FBI) registered 394 securities and commodities fraud criminal convictions resulting in restitution awards of $8.8 billion and nearly another $900 million in fines and broker-dealer forfeitures.[4]

The Ohio Division of Securities dedicates significant resources to bolstering investor protection and countering potential frauds.[5] The timely warning of investors by securities broker-

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[1] *See* Ohio Securities Division, *Ohio Securities Bulletin – Second Quarter* 9-10, (2006) http://www.com.ohio.gov/secu/docs/BUL062.pdf (accessed Nov. 12, 2012).
[2] Securities and Exchange Commission, *Select SEC and Market Data: Fiscal 2011*, (2012) http://www.sec.gov/about/secstats2011.pdf (accessed Nov. 12, 2012).
[3] Financial Industry Regulatory Authority, *FINRA Statistics*, (2012), http://www.finra.org/Newsroom/Statistics/ (accessed November 13, 2012).
[4] Federal Bureau of Investigation, *Financial Crimes Report to the Public: Fiscal Years 2010 – 2011*, (2011) (highlighting the volume of civil and criminal securities fraud proceedings and the substantial impact securities-related fraud has on investors and the national economy).
[5] Ohio Department of Commerce, *Ohio Con Artist Investor Education Campaign,* (2012) http://conartist.ohio.gov/ (accessed November 12, 2012) (warning that "[i]nvestment fraud schemes are taking a devastating toll on the life savings of Ohio investors"). The Ohio Department of Commerce – Securities Division has spearheaded a "Con Artist" marketing campaign and set up an investment fraud hotline, among other measures, as part of its consumer and securities fraud prevention efforts. *Id*.

dealers having the capacity and responsibility to do so is an integral part of effective anti-fraud measures.[6]

Ohio's Blue Sky Laws were enacted nearly a century ago in order to "guard investors against fraudulent enterprises, to prevent sales of securities based only on schemes purely speculative in character, and to protect the public from swindling peddlers…".[7] The Ohio Supreme Court has time and again emphasized this goal, noting that the protections enshrined in Section 1707 of the Ohio Revised Code are remedial in nature and designed to protect the investing public.[8] As a result, the duties imposed on broker-dealers by Section 1707 are to be "construed liberally to provide relief to the victims of fraud [they are] designed to protect."[9]

Recognizing a broker-dealer's duty to notify investors when their financial livelihood is imperiled by the reckless or unscrupulous actions or inaction of registered representatives is essential to fulfilling the Ohio legislature's goal of preventing catastrophic investment losses.

The Securities and Exchange Commission (SEC) has stressed the critical importance of providing increased information and disclosure in light of the growing complexity of investment products on the market so that investors may make more fully informed decisions. Pursuant to Section 917 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), the SEC conducted a study to identify the existing level of financial literacy among retail investors as well as to find better means and methods to increase financial literacy among investors. Not surprisingly, the study found investors have "a weak grasp of elementary financial concepts and lack critical knowledge of ways to avoid investment fraud."

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[6] *See generally id*.
[7] Groby v. State, 109 Ohio St. 543, 550, 143 N.E. 126 (1924).
[8] In re Columbus Skyline Securities, 73 Ohio St.3d 495, 498, 660 N.E.2d 427 (1996).
[9] Baker v. Conlan, 66 Ohio App.3d 454, 461, 585 N.E.2d 543 (1st Dist. 1990).

The SEC concluded that an "absolutely essential" requirement of the securities industry is to provide information to investors about a broker's "investment strategy."

Broker-dealers' obligations to comply with notice and disclosure requirements are particularly important given that the majority of retail investors do not understand the standards of care applicable to broker-dealers and investment advisers. SEC's Study on Investment Advisers and Broker-Dealers, completed in January 2011 pursuant to Section 913 of Title IX of the Dodd-Frank Act. The SEC study observes:

> [D]espite the extensive regulation of both investment advisers and broker-dealers, retail customers do not understand and are confused by the roles played by investment advisers and broker-dealers, and more importantly, the standards of care applicable to investment advisers and broker-dealers when providing personalized investment advice and recommendations about securities . . . Investors have a reasonable expectation that the advice that they are receiving is in their best interest. They should not have to parse through legal distinctions to determine whether the advice they receive was provided in accordance with their expectations." (at 101)

Ohio investors deserve the full protection of the federal and state securities laws, which are designed to promote disclosure of material information--particularly where, as here, an investor has a contractual relationship with a broker-dealer firm.

## II. STATEMENT OF THE CASE AND FACTS

*Amici* defer to the Statement of the Case and Facts presented by Appellants.

## III. ARGUMENT IN SUPPORT OF PROPOSITIONS OF LAW

**Proposition of Law No. 1: A broker-dealer of securities has an affirmative duty to notify its customers of misconduct by its officers, employees, or associated persons that may cause such customers to suffer financial harm. The broker-dealer may be held liable for any foreseeable harm resulting from its breach of this duty, even if the harm is realized after the termination of the contractual relationship between the broker-dealer and the customer.**

### A. FTS Had a Duty to Report Its Registered Representative's Misconduct Pursuant to the Securities Industry's State and Federal Regulatory Framework.

The federal and state regulatory structure of the securities industry is based upon disclosure of material information to provide transparency so that investors can make informed decisions and avoid fraud. See SEC v. Ralston Purina Co., 346 U.S. 119, 124 (1953) (citing A.C. Frost & Co. v. Coeur D'Alene Mines Corp., 312 U.S. 38, 40 (1941)).

Securities broker-dealer firms have a duty to notify a customer who may suffer investment losses as a result of misconduct by the firm's registered representative. See Twiss v. Kury, 25 F.3d 1551 (11th Cir. 1994); Prymak v. Contemporary Financial Solutions, Inc., 2007 U.S. Dist. LEXIS 87734 (D. Colo. 2007).

The affirmative regulatory obligation to notify investors of stockbroker misconduct is exemplified by the requirement that broker-dealers must report the circumstances of a stockbroker's departure on Form U-5. Upon termination of a registered representative, broker-dealers have a duty to file a notice of termination by way of Form U-5. Form U-5 "requires a member firm to state the reasons for terminating a registered representative." SII Investments, Inc. v. Jenks, 2006 WL 2092639 at *1 (M.D. Fla. 2006).

The information reported on Form U-5 is maintained in FINRA's Central Registration Depository ("CRD") system. Id. The CRD system is designed to provide regulators and the investing public access to accurate information about stockbrokers.[10] The U-5 form "enables the

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[10] Created in 1981 pursuant to policies developed by NASD and the North American Securities Administrators Association, Inc. (NASD-2002-168, at 6, 22), the CRD provides regulators access to a centralized repository of information about every registered firm or individual to assist them in fulfilling their regulatory responsibilities and investor protection obligations. NASD Notice to Members (NTM) 04-16, at 212. It also gives the public, most particularly investors and potential investors, access to accurate information about brokers with whom they conduct or might conduct business. (NASD-2002-168, at 7-8). Information about a

NASD 'to detect violations and subsequently sanction persons for violations of the NASD's rules and other applicable federal statutes and regulations.'" Andrews v. Prudential Sec., 160 F.3d 304, 309 (6th Cir. Mich. 1998) (*citations omitted*). The primary purpose of Form U-5 is "to provide notice to federal and state regulatory authorities, self-regulatory organizations and others that some event has occurred regarding a former employee of the submitting firm that may require a regulatory investigation. . . ." Dawson v. New York Life Ins. Co., 135 F.3d 1158, 1169 (7th Cir. Ill. 1998) (quoting from NASD's *amicus* brief filed in that case); see also SII Investments, 2006 WL 2092639 at *1 (Florida's Blue Sky provisions imposed a legal duty on broker-dealers "to accurately report in a U-5 the grounds for terminating an agent" so as to protect investors from financial injury caused by the agent's misconduct).

### B. FTS Is Liable for the Foreseeable Harm Arising out of Its Duty to Report.

Faced with facts similar to those presented here, courts have routinely held that when a broker-dealer fails to notify a customer of material information concerning the departure of a representative, it may be held liable for the customer's foreseeable financial harm. For example, in Palmer v. Shearson Lehman Hutton, Inc., 622 So. 2d 1085 (1st DCA 1993), a broker-dealer discovered violations of the securities laws by its representative and asked for his resignation. However, the firm's U-5 stated only that the representative had voluntarily resigned and falsely reported that the firm had no awareness of his misconduct. Id. at 1087-88. The representative moved to a new firm and continued to defraud investors, including Palmer. Palmer sued the initial broker-dealer firm for its failure to warn the regulators and the investing public about the

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firm's or individual's record in any state or SRO is contained in the CRD and is available to every other state, regulator and SRO. The effectiveness of the centralized national CRD system depends on its containing complete accurate information. State regulators, including the Attorney General, rely on the CRD in lieu of maintaining their own separate regulatory record systems. (*See* NASD NTM 99-09 (Feb. 1999) at 48.

representative's violations. The Florida First District Court of Appeal agreed, holding the broker-dealer firm liable for negligence *per se*, because (1) the firm breached its statutory duty by failing to report its representative's violations, (2) the investor belonged to the class of persons the statute was intended to protect, and (3) the investor's injuries were of the kind the statute was enacted to protect. Id. at 1090-91. The appellate court stated that:

> [t]his court should not shut its eyes or look askance at a securities dealer's knowing and willful violation of a clear statutory duty solely for the purpose of circumscribing the scope of that dealer's potential liability to persons not in privity with it, if it is made apparent that the dealer's failure to comply with the statute caused the type of injury to future investors that the statute was designed to prevent. We adamantly reject the notion that [the broker-dealer firm] neither could nor should have foreseen that an injury of this nature could occur to persons in [the investors'] position as a consequence of its filing false in formation in the report of [the representative's] termination with the Department.

Palmer, 622 So. 2d at 1092. See also Twiss v. Kury, 25 F.3d 1551, 1556-57 (11th Cir. 1994) (faced with similar facts, the Eleventh Circuit held that the Florida Blue Sky Laws supported a claim for negligence premised on the failure to accurately report information about its agent on the firm's U-5).

Courts in other jurisdictions have reached the same conclusion. In Prymak v. Contemporary Financial Solutions, Inc., 2007 U.S. Dist. LEXIS 87734 at *29 (D. Colo. 2007), investors in Arkansas, Colorado, and California purchased short-term promissory notes in a fraudulent scheme from a stockbroker *after* the stockbroker had left the defendant broker-dealer firm. The broker-dealer firm had become aware of its stockbroker's sale of notes during his employment and the Arkansas Securities Department (ASD) had started an investigation. The broker-dealer firm misled the ASD and terminated the broker, who continued to sell the promissory notes to investors, including the plaintiffs. The broker-dealer firm filed a false U-5

form, claiming that the broker "voluntarily" resigned and falsely stating that he was not the subject of any investigation. Id. at *2-4.

The district court held that the broker-dealer was liable for negligence *per se* to the victims investing after the stockbroker's departure. The Court noted that the plaintiff-investors were among the group of persons the securities regulatory schemes in Arkansas, California, and Colorado were designed to protect and had suffered the types of injuries they were enacted to prevent. Id. at *8. The broker-dealer firm's violation of its reporting requirements constituted negligence *per se*, even if the statutes themselves did not create a private cause of action. Id. at *9.

In an analysis particularly relevant to the case at bar, the Prymak court distinguished between plaintiffs who had been clients of the broker-dealer and left with the representative, and those who had not. The Court held that the customer-plaintiffs had a valid cause of action for negligence based upon the firm's failure to disclose the broker's wrongful conduct because "a fiduciary relationship, once established between a broker and a client, necessarily extends to the broker dealer." Id. at *13 (citations omitted). The firm had a duty to protect its customers which did not terminate when the customers left to follow the broker. Id.

In this case, it is alleged that FTS was aware that its registered representative, Hughes, had employed an investment strategy that was unsuitable for *any* of its customers. FTS was sufficiently concerned about Hughes' conduct that it placed him under heightened supervision and brought in an options expert to evaluate his strategy. FTS concluded that the risks associated with Hughes's strategy were unreasonable and unsuitable *for any investor*, but failed to notify its customers. FTS also gave Hughes an "ultimatum" to cease using the strategy or leave the firm. In these circumstances, Hughes's resulting departure was certainly not voluntary, but FTS failed

to report this fact on Hughes' U-5, depriving its customers of this vital information. As did the broker-dealer firms in Palmer, Twiss, and Prymak, FTS had an obligation to accurately report the misconduct of its registered representative and the circumstances surrounding his involuntary termination and failed to do so thus leaving its customers in the dark. As did the broker-dealers' conduct in those cases, FTS' conduct runs afoul of the Ohio Blue Sky Laws' accurate reporting requirements.[11]

### C. FTS's Duty to Independently Notify Appellants Arises from the Fiduciary Duties FTS Owed Appellants.

The court below acknowledged that "a fiduciary duty existed" between FTS and appellants. See LaWarre v. Fifth Third Securities, Inc., 2012 WL 3834052 *8 {¶44}. Whether the broker exercises formal discretionary trading authority, or, as here, assumes *de facto* discretionary authority, the fiduciary duty owed by the broker to the customer remains the same. See Burns v. Prudential Securities, Inc., 167 Ohio App.3d 809, 857 N.E.2d 621, 635 (2006), citing De Kwiatkowski v. Bear, Stearns & Co., Inc. (C.A.2, 2002), 306 F.3d 1293; J.C. Bradford Futures, Inc. v. Dahlonega Mint, Inc. (C.A.6, 1990), 907 F.2d 150. As fiduciaries, brokers have the "duties to keep customers informed regarding the changes in the market that affect the customer's interest and to explain the practical impact and potential risks of the course of dealing in which the broker is engaged." Id.

As a fiduciary, FTS was obligated to provide material information to its customers about Hughes' trading strategy, including the fact that FTS considered the strategy unsuitable for *any* investor, and that it forced Hughes out when he continued to follow it. Because its fiduciary duty to provide this information arose *during* the relationship, FTS should not be allowed to

[11] The Ohio Blue Sky law reporting requirements for broker-dealer firms are substantially similar to those of Florida. See Florida Securities and Investor Protection Act, Chapter 517, Title XXXIII, Fla. Stats.

avoid it by failing to notify investors and claiming that the relationship had ceased. As the Third Circuit held in Glaziers and Glassworkers Union Local No. 252 Annuity Fund v. Newbridge Securities, Inc., 93 F.3d 1171, 1183 (3rd Cir. 1996), a broker-dealer that has acquired information about wrongdoing on the part of its representative retains a "fiduciary duty to advise the [customers] of information they needed for their own protection" even after the customer leaves the firm to follow the representative.

### D. The Current Decision, If Allowed to Stand, Would Be Contrary to Public Interest.

The lower court's decision is contrary to public interest because, if it stands, it will enable securities broker-dealer firms to insulate themselves from the foreseeable consequences of their *own* failure to warn or other similar misconduct by terminating their relationships with a culpable broker and with their customers *prior* to the customers' losses.[12] This decision wrongly replaces foreseeability with an arbitrary event, specifically, the date the broker is separated from the firm. Further, this event is subject to the control of the broker-dealer firm, which may therefore manipulate it in order to avoid liability. This result is illogical, gives broker-dealers an unfair avoidance mechanism, and is at odds with the fundamental regulatory structure of notice and disclosure and with the public interest of Ohio investors.

## IV. CONCLUSION.

For these reasons, this Court should accept jurisdiction in this case.

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[12] Such a ruling would create perverse incentives for broker-dealer firms to act quickly and avoid liability rather than prevent or mitigate investor losses. The Court's decision is akin to allowing a hospital that discovers that a physician on its staff has wrongly administered a life-threatening medication to fire the doctor and discharge the patient without warning him that the medication he is about to take will put his life in danger, thus avoiding liability.

Respectfully submitted,

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Certificate of Service

I certify that a true copy of the foregoing Memorandum of *Amici Curiae* in Support of Jurisdiction was sent by ordinary U.S. mail, postage prepaid, this ___ day of November, 2012, to the following:

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