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 IN SUPPORT OF MOTION FOR RECONSIDERATION

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The Public Investors Arbitration Bar Association, Inc. ("PIABA") respectfully submits this Amicus Curiae Brief in support of Plaintiffs-Appellants Motion for Reconsideration.

As described in greater detail in its principal Amicus Brief, 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 arbitration and court disputes against brokerage firms, brokers, and financial advisors.

ARGUMENT AND CITATION OF AUTHORITIES

I. This Court Should Clarify Its Answer To The Second Circuit Court Of Appeals' Second Certified Question To Make Clear That The Rule Enunciated Applies Only To Tort Claims That in Fact Allege a "Fraud On The Market" in Publicly Traded Securities.

At pages 12-13 of its opinion, this Court held that "with respect to a tort claim based on misrepresentations or omissions concerning publicly traded securities, a plaintiff at trial has the burden of proving that the truth concealed by the defendant entered the marketplace, thereby precipitating a drop in the price of the security."

PIABA supports reconsideration so that the Court can make explicit what is implicit in its articulation of the burden of proving "loss causation": That the rule enunciated applies ***only*** to those cases where, in fact, the allegation is that there was a "fraud on the market" – a material misrepresentation or omission regarding a publicly traded security that affected the price of the security, and is therefore presumed to have been relied on by purchasers of the security.

As the Court is aware, "[t]he 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." *Basic Inc. v. Levinson*, 485 U.S. 224, 241–42, 108 S. Ct. 978, 989 (1988) (omission in original) (*quoting Peil v. Speiser*, 806 F.2d 1154, 1160 (3d Cir. 1986)). Such claims are typically brought where, for example, the issuer of a security disseminates false financial information in the marketplace on which the investing public as a whole is presumed to rely. The Enron scandal is an example of such a fraud perpetrated on the market as a whole. When the fraud was revealed, shares of Enron declined precipitously.

Various misrepresentations and omissions can, in fact, affect the price of a security as set by market forces. But there is a broad array of other falsehoods perpetrated upon individual investors that do not make their way into the marketplace and therefore can have no affect on the market price of a security. These would include, for example, various types of misrepresentations specifically made to an individual investor by a stockbroker to induce a purchase or sale, and which were actually relied upon by the investor in making the investment decision, but which are not disseminated to the market as a whole.[1]

In those instances, the claim is not that there has been a "fraud on the market" (because there was no widespread dissemination of false information), but instead, the claim is that "but for" the misrepresentation or omission specifically directed at and relied upon by the individual investor, the stock purchase or sale never would have occurred. For those cases, suggesting that a plaintiff prove "that the truth concealed by the defendant entered the marketplace, thereby precipitating a drop in the price of the security" is a *non sequitur*, clearly having no applicability to the factual context of the specific fraudulent inducement made. PIABA urges the Court to make that distinction clear.

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[1] For example, an unscrupulous advisor might induce a naïve investor to purchase the stock of a company by falsely claiming that the broker himself owns the stock, that the company is about to be acquired, that the company has a unique product coming to market, or that the company is on the verge of being awarded a large contract. Those types of fraudulent fact patterns are common in individual investor cases. If those misrepresentations are made solely within a discrete investor/broker relationship, and are not disseminated widely to the investing public (by, for example, a materially misleading press release issued by the company), there has been "no fraud on the market" which could have affected the pricing of the security.

Cases in which individual investors have asserted tort claims against their brokers and advisors are instructive.[2] For example, *Hatrock v. Edward D. Jones & Co.*, 750 F.2d 767, 773 (9th Cir. 1984), a stock broker repeatedly made misrepresentations about upcoming corporate takeovers, encouraging clients to engage in repeated sale and re-acquisition of certain stocks, whose value steadily declined. The sole purpose of the misrepresentations was to enable the broker to generate commissions. The Ninth Circuit concluded that "the customer may hold the broker liable for churning without proving loss causation." 750 F.2d at 773. Similarly, in *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167 (2d Cir. 1970), an investor sued a brokerage firm for damages that resulted from the firm's failure to inform the investor that it was making a market in the securities it sold to plaintiff. In rejecting a challenge to the amount of damages awarded against the firm, the court observed that "[t]he issue is not whether Smith, Barney was actually manipulating the price on Chasins or whether he paid a fair price, but rather the possible effect of disclosure of Smith, Barney's market-making role on Chasins' decision to purchase at all on Smith, Barney's recommendation. It is the latter

[2] Since the Supreme Court's 1987 decision in *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220 (1987), the overwhelming majority of disputes between individual investors and their stockbrokers have been resolved by compulsory arbitration under the auspices of the NASD, NYSE, AMEX, and now FINRA. As a result, there are relatively few recently reported court cases concerning individual investor claims of fraud and misrepresentation.

inducement to purchase by Smith, Barney without disclosure of its interest that is the basis of this violation; the evil in such a case is that recommendations to clients will be based upon the best interests of the dealer rather than the client." 438 F.2d at 1173. In other words, it was the misrepresentation inducing the transaction that was the proximate cause of the damages suffered.

Proof of loss causation (i.e., presumed reliance) that is required for a "fraud on the market" case has no application for the types of common law tort claims often asserted by individual investors. For example, in a case alleging that a broker misrepresented to an investor that a particular publicly traded security was a suitable investment, the misrepresentation of suitability is the cause of the damages suffered. "The plaintiff . . . ***should not have to prove loss causation*** where the evil is not the price the investor paid for a security, but the broker's fraudulent inducement of the investor to purchase the security." *Hatrock, supra*, 750 F.2d at 773 (emphasis added). In other words, revealing to the "marketplace" that the security was unsuitable for that individual investor will not "precipitat[e] a drop in the price of the security." Similarly, if an advisor fails to disclose that the excessive trading activity undertaken in an investor's account -- known as "churning" – is a risky and speculative strategy, the eventual disclosure of that fact will not be the cause of any drop in value of the churned portfolio. *See, e.g.,* *Bastian v. Petren Res. Corp.*, 681 F. Supp. 530, 535 (N.D. Ill. 1988) (noting that courts have rejected a "loss causation" requirement in cases involving churning of client accounts).

In sum, PIABA supports reconsideration so that the Court can properly narrow and clarify its holding, which otherwise might improperly be claimed to require that ***all*** plaintiffs asserting ***any*** tort claim based on misrepresentations or omissions concerning publicly traded securities ***must*** prove that the revelation of the truth precipitated a drop in the price of the securities. As shown, such an interpretation of the rule is wholly inapplicable to a large segment of legal claims typically brought by individual public investors, which do not allege widespread dissemination of false information causing a "fraud on the market." Indeed, a broad and indiscriminate application of this Court's answer to the second certified question could well eviscerate a significant portion of "holder" cases, which this Court held viable in Georgia in its answer to the first certified question presented by the Second Circuit.[3]

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[3] In that portion of the opinion, the Court held that negligent misrepresentation claims and fraud claims "can be based on forbearance in the sale of publicly traded securities." Slip Op. 9-10. As an example, a claim alleging that an investor was induced to hold a security based on negligent tax advice given by their broker would state a cause of action. But would that investor also have to prove that the negligent tax advice "entered the marketplace" and caused a "drop in the price of the security" held? Since the negligent tax advice would have been specific to the

Accordingly, PIABA urges this Court to reconsider and clarify its response to the second question certified to it by the Second Circuit Court of Appeals.

This 9th day of March, 2010.

Respectfully submitted,

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investor's circumstances, that negligence would clearly have no market affect on the price of the security.

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 IN SUPPORT OF MOTION FOR RECONSIDERATION" 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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