A Look at the Law

Theories of Stockbroker and Brokerage Firm Liability

By Robert C. Port

Over a lifetime, even modest savings, contributions to an IRA, or participation in an employee pension plan can result in significant accumulations of wealth.[1] However, many individuals have neither the interest nor the desire to learn about financial markets and investments, nor do they have the time necessary to monitor their investments on an ongoing basis. Their aversion to and confusion about financial matters has been further accentuated by the "irrational exuberance"[2] of the "Internet bubble" of the late 1990s, and subsequent significant decline in the value of technology and telecommunications stock. As a result, many individuals turn to stockbrokers, investment advisors, financial planners, insurance agents, and others claiming to have the knowledge and experience to offer investment advice.

Stockbrokers and other financial advisors are highly motivated to cultivate their clients' trust and allegiance, and clients who lack knowledge and sophistication on financial matters have powerful incentives to believe that such advisors are trustworthy and acting solely in the customer's best interests.[3] This trusting relationship creates an opportunity for exploitation by the advisor, which may form the basis for a variety of legal claims. Common fact patterns associated with broker misconduct include misrepresentation, churning, unsuitable recommendations, unauthorized trading, and failure to supervise. Outright misrepresentation and fraud may also be practiced on the unsuspecting and trusting client.

Federal and state securities statutes and state common law typi-

cally govern civil liability in connection with losses arising from the purchase and sale of securities. The self-regulatory rules of the National Association of Securities Dealers and the New York Stock Exchange are also relevant to the issue of whether a broker or financial advisor owed or breached a duty to the customer. The following is a brief overview of common legal theories of liability that apply to broker misconduct.[4]

FRAUDULENT MISREPRESENTATIONS AND OMISSIONS

Material misrepresentations and omissions made in connection with the purchase or sale of a security can violate federal and state securities statutes. Such claims may also proceed as common law fraud claims.

Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5

Section 10 of the Securities Exchange Act of 1934,[5] is an anti-fraud provision prohibiting the use "in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance." Rule 10b-5 promulgated by the Securities Exchange Commission amplifies these prohibitions by making it unlawful:

> (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[6]

The essential elements of a Rule 10b-5 claim are: (1) a misstatement or omission; (2) of a material fact; (3) made with scienter, (4) upon which the plaintiff relied; (5) that proximately caused the plaintiff's loss.[7]

The standard for determining materiality is whether "there is a substantial likelihood that a reasonable shareholder would consider it important" or "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[8]

"To constitute fraud, a misrepresentation generally must relate to an existing or pre-existing fact."[9] A misrepresentation of future profit generally cannot constitute fraud, as it is a type of opinion and prediction of future events.[10] "[O]utrageous generalized statements, not making specific claims, that are so exaggerated as to preclude reliance by consumers" generally will be deemed "puffing" rather than fraud.[11] Furthermore, the "in connection with" requirement in Rule 10b-5 is not satisfied by any misrepresentations or omissions that occur after the claimant purchases or sells the security in question.[12]

The Supreme Court has expressly left open the question of whether the scienter requirement encompasses not only intentional conduct, but also reckless conduct.[13] The rule in the 11th Circuit is that a showing of "severe recklessness" satisfies the scienter requirement.[14] "Severe recklessness is limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it."[15]

The plaintiff's reliance must have been reasonable or justified.[16] Relevant factors include: (1) the sophistication and expertise of the plaintiff in financial and security matters; (2) the existence of long standing business or personal relationships between the plaintiff and the defendant; (3) the plaintiff's access to relevant information; (4) the existence of a fiduciary relationship owed by the defendant to the plaintiff, (5) concealment of fraud by the defendant; (6) whether the plaintiff initiated the stock transaction or sought to expedite the transaction; and (8) the generality or specificity of the misrepresentations.[17]

To prove the causation element, a plaintiff must prove both "transaction causation" and "loss causation."[18] Transaction causation is a synonym for reliance, and is established when the misrepresentations or omissions cause the plaintiff "to engage in the transaction in question."[19] Loss causation is more difficult to prove: the misrepresentation must have caused the loss suffered by the claimant. Loss causation is satisfied "only if the misrepresentation touches upon the reasons for the investment's decline in value."[20] Proof of loss causation is a statutory requirement.[21]

Section 12(2) of the Securities Act of 1933

Section 12(2) of the Securities Exchange Act of 1933 provides that any person who offers or sells a security by use of an oral or written

communication that contains an untrue statement of material fact or omits to state a material fact necessary in order to make the statement not misleading is liable to the purchaser, *unless* the seller can show that he did not know and in the exercise of reasonable care could not have known of the untruth or omission.[22] Scienter is *not* an element of a Section 12(2) claim.

Although the scope of liability under Section 12(2) is potentially broad, its reach for broker misconduct nonetheless is limited by four factors. First, the claimant is limited to rescission or rescessionary damages (the purchase price of the security, plus interest, less income received thereon) and must tender the security back to the seller. If the claimant no longer owns the security, he may seek damages representing the difference in the purchase price and the sale price. Second, only purchasers may assert claims under Section 12(2), and they may assert them only against sellers and persons who control them. A "seller" is one who either transfers title to the security or who solicits the sale and receives a benefit from doing so or acts with the intent to benefit the owner of the security.[23] Third, the statute of limitations is a substantive element of the claim and compliance must be affirmatively pled. Fourth, Section 12(2) applies only to initial public offerings by means of a formal offering document (not private placements or secondary market transactions).[24]

Georgia Securities Act

The Georgia Securities Act provides a cause of action against a seller of securities for making "an untrue statement of a material fact or omit[ing] to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading."[25] Liability will not be found however, if "(1) [t]he purchaser knew of the untrue statement of a material fact or omission of a statement of a material fact; or (2) [t]he seller did not know and in the exercise of reasonable care could not have known of the untrue statement or misleading omission."[26]

The remedies provided under the Georgia Act are available only to a buyer of securities.[27] Because there is very little case law construing the Georgia Securities Act, the courts often look to analogous federal statutes for interpretive assistance. For example, although the language of the Georgia statute does not appear to require scienter, courts have construed the section in accordance with Rule 10b-5 as requiring proof of scienter.[28] One of the advantages of a claimant proceeding under the Georgia Act, however, is provision for recovery of attorney's fees, interest, and court costs.[29]

Common Law Fraud

Under Georgia law, fraud is shown when (i) a representation of material fact is made (or there is a failure to disclose a material fact); (ii) that was known or should have been known to be false (or should have been disclosed); (iii) that was made (or omitted) for the purpose of being relied upon by another; (iv) that was in fact relied upon; (v) that caused damage.[30] Under Georgia law, a "promise to perform some future act is not fraud unless made with the present intent not to perform or with a present knowledge that the future event will not take place."[31]

Nondisclosure may provide the basis for constructive fraud where a party is under an obligation to communicate. "The obligation to communicate may arise from the confidential relations of the parties or from the particular circumstances of the case."[32] Under Georgia law, "a confidential relationship imposes a greater duty on the parties to reveal what should be revealed, and a lessened duty to discover independently what could have been discovered through the exercise of ordinary care."[33]

Not all representations by a broker are actionable by an investor. For example, an investor is not justified in relying upon representations consisting of mere expressions of opinion, hope, expectation and puffing.[34] Thus, speculations or puffing as to future performance and statements that a particular security is a "safe investment" are generally not actionable.[35]

CHURNING

"Churning occurs when a securities broker buys and sells securities for a customer's account, without regard to the customer's investment interests, for the purpose of generating commissions."[36] Churning is a violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.[37] Similarly, Georgia's "Blue Sky" regulation promulgated under the Georgia Securities Act authorizes the Georgia Commissioner of Securities to take action against brokers who "induc[e] trading in a customer's account which is excessive in size or frequency in view of the financial resources and character of the account."[38] Violation of this rule is an "unlawful practice" under the Georgia Securities Act[39] and may allow the buyer to invoke a statutory rescessionary remedy in a civil action against the seller.[40]

Proving a Churning Claim

The essence of a churning claim is that the broker has used his control over an account to generate excessive commissions, "while at the same time leading his customer to believe that he is attempting to fulfill the customer's investment objectives."[41] Churning requires proof of three elements: (1) control over the account by the broker; (2) trading in the account that is excessive in light of the customer's investment objectives; and (3) the broker's intent to defraud or his willful or reckless disregard of the customer's interest.[42]

Control of Account by Broker

The broker's control may be shown either by (i) the customer's express grant of discretionary trading authority over the account, or (ii) the broker's acquiring de facto control over the account by, for example, gaining the customer's confidence and inducing the customer to engage in excessive trading.

Express grant of discretionary power

In a discretionary account, the customer gives the broker discretion as to the purchase and sale of securities, including selection, timing and price to be paid or received. Any formal grant of discretionary control given to a broker must be in writing.[43] A broker or his representative who exercises discretionary authority over an account owes his client "the highest obligation of good faith and fair dealing."[44]

De facto control

A broker may exercise *de facto* control if an investor places his trust and faith in a broker and routinely follows the advice of his broker. Whether a broker has acquired control over the account is a fact-based inquiry. The factors used in evaluating control include: 1) the age, education, intelligence, and investment and business experience of the customer; 2) the relationship between the customer and the account executive; 3) the customer's knowledge of the market and the account; 4) the regularity of discussions between the account executive and the customer; 5) whether the customer actually authorized each trade; and 6) who made the recommendations for trades.[45]

Excessive Activity

Courts examine various factors to determine whether there is excessive activity indicative of churning, including the rate of turnover in the customer's account, account maintenance costs, the holding periods for the securities in the customer's account, and the significance of the fees generated to the broker.

The turnover ratio is a statistical measure of how many times in a given period the securities in a customer's account have been replaced by new securities recommended by the broker. "Excessive trading is generally held to exist when there is an annual turnover rate in an account in excess of six."[46] The turnover ratio is the cost of all purchases for the relevant period divided by the average monthly account value for that period. Whether a particular turnover rate is excessive depends on the investment objectives of the customer. In long term accounts, a lower turnover rate may be deemed excessive.[47] In trading accounts, a higher turnover rate is expected.[48]

The account maintenance cost, also known as "equity maintenance factor" or the "cost-equity ratio," is a computation of the rate of return the client must earn on the account to pay the commissions and other trading fees (such as margin interest) caused by churning. For example, if an account with average annual equity of $100,000 generates $25,000 in fees and commissions in a year, the investor would have to earn a 25 percent annualized return just to break even. A high account maintenance cost indicates that the account has been excessively traded not for the client's benefit, but for the benefit of the broker.[49]

Churning may also be suggested by an analysis of the period of time a security is held from the date of purchase to the date of sale. Very short holding periods, with the sale

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proceeds immediately reinvested in other securities, may be indicative of churning activity.[50] If a single customer's account provides a significant portion of the commissions earned by a broker or the branch office in which that account is located, this may be additional evidence of churning.[51]

UNSUITABLE RECOMMENDATIONS

Unsuitable recommendations can encompass a variety of factual circumstances, including over concentration or failure to diversify,[52] use of excessive margin,[53] failure to use hedge strategies,[54] and mutual fund or annuity switching.[55] NASD Conduct Rules allow a broker to recommend a securities transaction only if the broker has "reasonable grounds for believing that the recommendation is suitable for such customer" based on "the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."[56]

To prove a Rule 10b-5 cause of action for unsuitability, the plaintiff must show (1) that the securities purchased were unsuited to customer's needs; (2) that the broker knew or reasonably believed the securities were unsuited to the customer's needs; (3) that the broker recommended or purchased the unsuitable securities for the customer anyway; (4) that, with scienter, the broker made material misrepresentations (or, owing a duty to the customer, failed to disclose material information) relating to the suitability of the securities; and (5) that the customer justifiably relied to its detriment on the broker's fraudulent conduct."[57]

Unsuitable recommendations may also give rise to state law causes of action under theories of breach of contract, breach of fiduciary duty, and negligence. The Georgia Blue Sky Regulations prohibit a broker from recommending a security transaction "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]."[58] Violation of the rule is a violation of the Georgia Securities Act.[59]

UNAUTHORIZED TRADING

A broker is prohibited from executing a trade in an account unless the client has approved and authorized the trade, *before* the trade has been made, either by written discretionary authority given to the broker (such as a Power of Attorney), or by oral "time and place" discretion granted to the broker.[60] Unauthorized trading occurs when a broker effects trades in a client's account without having either written or oral authority to do so.[61]

Generally, the courts have concluded that unauthorized trading, by itself, does not constitute a violation of Rule 10b-5.[62] However, unauthorized trading may be sufficient to maintain state law claims of breach of contract, breach of fiduciary duty, and negligence. Georgia's Blue Sky Regulations also prohibit unauthorized trading.[63]

STATE COMMON LAW CLAIMS

Claims may also be brought against brokers based on negligence or breach of fiduciary duty. Under Georgia law, a confidential, fiduciary relationship exists between a broker and his client.[64]

A broker's violation of his regulatory duties, while generally recognized to not give rise to a private right of action, may provide evidence in evaluating whether the broker properly exercised the required degree of care in his dealings with a customer.[65] Securities statutes and conduct rules also require broker/dealer to reasonably supervise their brokers "with a view to preventing violations [of the securities law]."[66]

A number of courts have held that a violation of regulatory rules may be the basis of a claim sounding in negligence.[67]

SELLING AWAY

"Selling Away" describes instances where a broker sells securities outside of the firm with which he or she is associated.[68] NASD Conduct Rules 3030 and 3040 prohibit, respectively, unapproved outside business activities and private securities transactions. The ability of a broker to engage in "selling away" may be indicative of the brokerage firm's failure to adequately supervise its brokers.

Securities firms have been held liable for the activities of their brokers in selling away under the "control person" liability imposed by Section 20 of the Securities and Exchange Act.[69] The fact that the firm had "potential control" over the conduct giving rise to the violation is generally sufficient to impose liability.[70] Additionally, respondeat superior provides a basis for recovery in such circumstances, since the broker conducted the transactions in the apparent ordinary course of business of that broker.[71]

VIOLATION OF MARGIN REGULATIONS

Rule 10b-16[72] provides that it is unlawful for a broker to extend credit to a customer in connection with any securities transaction unless the broker has established a procedure to assure that the customer received, at the time he opens his account, a written disclosure regarding interest and other charges. There is a division of opinion on whether there is an implied private right of action under Rule 10b-16.[73]

BREACH OF CONTRACT

Most customer agreements and trade confirmations incorporate industry rules and regulations into the contract with the customer.[74] Therefore, violations of industry rules and regulations by the broker/dealer or registered representative may give rise to a breach of contract claim if damage results. Additionally, there is implied in all contracts the duty of good faith and fair dealing.[75]

CONTROL PERSON LIABILITY

Under Section 20(a) of the Securities and Exchange Act, any person who directly or indirectly controls any person who is liable for selling securities in violation of the Act is liable to the same extent as the seller, unless he acted in good faith and did not directly or indirectly induce the conduct at issue.[76] A broker/dealer may be liable as a "controlling person" for the acts of its brokers if the broker/dealer has "some indirect means of discipline or influence" over them.[77]

The Georgia Securities Act also provides for liability of "control persons," subject to a "good faith defense."[78] Liability under the statute is predicated on control of the agent, and habit and course of dealing may be considered in determining control.[79] Further, a controlling person may be deemed to have ratified the unauthorized act when facts put him on notice of the act and he takes no steps to further investigate or return proceeds from the act.[80] A controlling person may escape liability by showing that "he did not take an active part in the violation, that he did not know of the violation and that as a reasonably prudent man he would not have discovered the violation."[81]

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RESPONDEAT SUPERIOR/AGENCY PRINCIPLES

Under common law agency principles, the principal (the broker/dealer) is liable for the torts of its agents (its registered representatives) done within the scope of the principal's business.[82] Under this theory, broker/dealers typically are held responsible for a representative's unintentional acts in handling a customer account as well as some intentional actions taken within the scope of handling the account, such as churning and placing unauthorized trades. Georgia law has codified a number of duties of the agent to his principal, including: (1) the duty to exercise ordinary care, skill and diligence respecting the business of his principal;[83] (2) the duty to follow his principal's instructions;[84] (3) the duty not to sell to or purchase from his principal for his own account without first disclosing all of the facts;[85] (4) the duty to account to his principal for all profit he makes from his principal's property.[86]

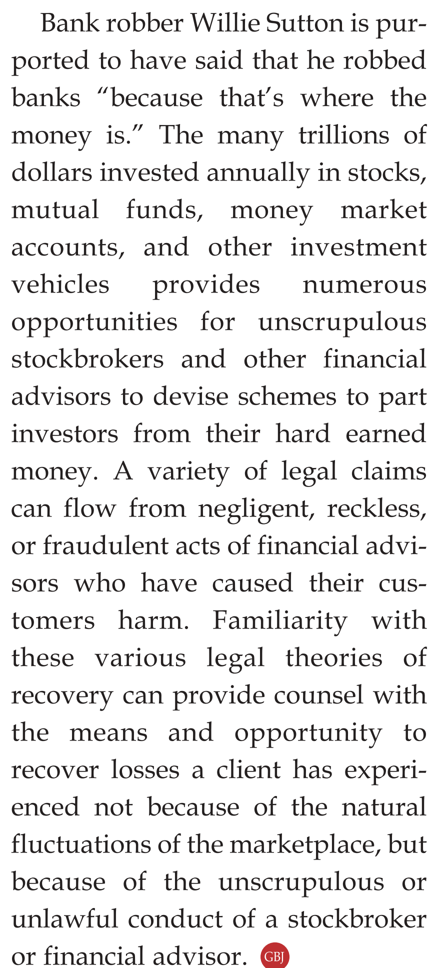
RICO

As a result of the Private Securities Litigation Reform Act of 1995, conduct which could have been pursued under the federal securities laws cannot now be used as predicate acts for federal RICO.[87] The Georgia RICO statute, on the other hand, specifically provides that "racketeering activity" includes committing, attempting to commit, soliciting, coercing, or intimidating another person to commit a willful violation of the Georgia Securities Act of 1973, O.C.G.A. § 10-5-24.[88] Under Georgia's RICO Act, the claimant is entitled to recover "three times the actual damages sustained and, where appropriate, punitive damages. Such person *shall* also recover attorneys' fees . . . and costs of investigation and litigation reasonably incurred."[89]

FAIR BUSINESS PRACTICES ACT

The Fair Business Practices Act, O.C.G.A. § 10-1-390 *et seq*. has been found not to apply to securities or commodities transactions. In considering the question, the court concluded that "where a consumer remedy exists, with no need to fill in a legal gap or create a consumer right, and where the industry which is the subject matter of the situation explicitly defines wrongful conduct or unfair and deceptive practices, the FBPA has no application."[90]

CONCLUSION



Bank robber Willie Sutton is purported to have said that he robbed banks "because that's where the money is." The many trillions of dollars invested annually in stocks, mutual funds, money market accounts, and other investment vehicles provides numerous opportunities for unscrupulous stockbrokers and other financial advisors to devise schemes to part investors from their hard earned money. A variety of legal claims can flow from negligent, reckless, or fraudulent acts of financial advisors who have caused their customers harm. Familiarity with these various legal theories of recovery can provide counsel with the means and opportunity to recover losses a client has experienced not because of the natural fluctuations of the marketplace, but because of the unscrupulous or unlawful conduct of a stockbroker or financial advisor. GBJ

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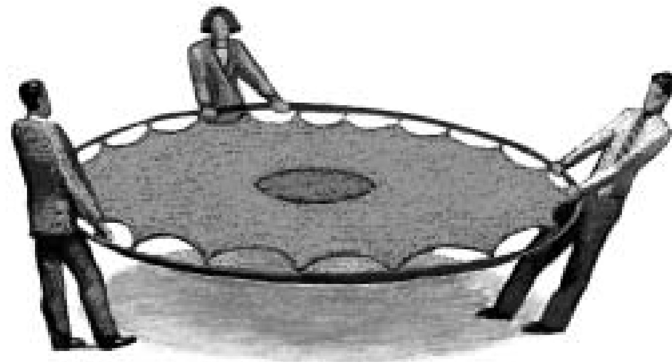
Endnotes

1. A 2003 study by the Internal Revenue Service concluded that at the end of 2002, $2.3 trillion was invested in IRA assets, compared to $637 billion invested at the end of 1990. For the year ending in 2002, 46 percent of those IRA assets were in mutual funds, 34 percent were in securities held in brokerage accounts, 11 percent were held in bank deposits, and the remaining 9 percent were held in annuities at life insurance companies. Peter Sailer & Kurt Gurka, Internal Revenue Service, *Accumulation and Distributions of Retirement Assets, 1996-2000-Results from a Matched File of Tax Returns and Information Returns, available at* http://www.irs.gov/pub/irs-soi/03pete.pdf (2003).
2. Federal Reserve Chairman Alan Greenspan, *The Challenge of Central Banking in a Democratic Society,* Address at the American Enterprise Institute for Public Policy Research Annual Dinner and Francis Boyer Lecture (December 5, 1996) *available at* http://www.federalreserve.gov/boarddocs/speeches/1996/19961205.htm.
3. Donald C. Langevoort, *Selling Hope, Selling Risk: Some Lessons for Law from Behavioral Economics About Stockbrokers and Sophisticated Customers*, 84 CAL. L. REV. 627 (1996).
4. 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 stock-



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brokers have been resolved by compulsory arbitration under the auspices of the NASD, NYSE, AMEX, or other self-regulatory organizations. The decisions reached by arbitration panels, though publicly available, do not generally give a written rationale for the decision, and are deemed final and not subject to appeal or judicial review except in very limited circumstances. *See, e.g.,* 9 U.S.C. § 10 (setting forth grounds vacating an arbitration award); O.C.G.A. § 9-9-13 (Supp. 2003) (same). Nor do such arbitration awards have the precedential value of a court decision. *See, e.g.,* El Dorado Technical Services, Inc. v. Union General de Trabajadores de Puerto Rico, 961 F.2d 317, 321 (1st Cir. 1992). As a result, the development of the law in this area has been stagnant, since it is not subject to the continued refinement, analysis, and appellate review that would otherwise have occurred in litigated claims.
5. 15 U.S.C. § 78j(b) (2000).
6. 17 C.F.R. § 240.10b-5 (2000).
7. *See* Gochnauer v. A.G. Edwards & Sons, Inc., 810 F.2d 1042, 1046 (11th Cir. 1987); McDonald v. Alan Bush Brokerage Co., 863 F.2d 809 (11th Cir. 1989).
8. TCS Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976); *see also* SEC v. Carriba Air, Inc., 681 F.2d 1318, 1323 (11th Cir. 1982) ("The test for determining materiality is whether a reasonable man would attach importance to the fact misrepresented or omitted in determining his course of action.").
9. Miller v. Premier Corp., 608 F.2d 973, 981 (4th Cir. 1979).
10. *Id.*; *see also* Bogle v. Bragg, 248 Ga. App. 632, 637, 548 S.E.2d 396, 401 (2001) (finding a statement that security was "a safe investment" to be an opinion, not actionable fraud).
11. Cook, Perkiss & Liehe, Inc. v. Northern California Collection Service Inc., 911 F.2d 242, 246 (9th Cir. 1990) (quoting Metro Mobile CTS, Inc. v. NewVector Communications, Inc., 643 F. Supp. 1289, 1292 (D. Ariz. 1986), *rev'd without opinion*, 803 F.2d 724 (9th Cir. 1986)).
12. *See* Shamrock Assocs. v. Moraga Corp., 557 F.Supp. 198, 203 (D. Del. 1983); Troyer v. Karcagi, 476 F. Supp. 1142, 1148 (S.D.N.Y. 1979).
13. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12, (1976).
14. McDonald v. Alan Bush Brokerage Co., 863 F.2d 809, 814 (11th Cir. 1989).
15. Broad v. Rockwell International Corp., 642 F.2d 929, 961 (5th Cir. 1981) (en banc).
16. Bruschi v. Brown, 876 F.2d 1526 (11th Cir. 1989).
17. *Id*. at 1529.
18. Robbins v. Koger Props., 116 F.3d 1441 (11th Cir. 1997).
19. *Id*. (quoting Currie v. Cayman Resources Corp., 835 F.2d 780, 785 (11th Cir.1988)).
20. Huddleston v. Herman & MacLean, 640 F.2d 534, 549 (5th Cir. 1981), *aff'd in part, rev'd in part on other grounds*, 459 U.S. 375 (1983); *see also* Currie v. Cayman Resources, 835 F.2d 780, 785 (11th Cir. 1988); Rousseff v. E.F. Hutton, 843 F.2d 1326, 1329 (11th Cir. 1988).
21. 15 U.S.C. § 78u4(b) (2000).
22. 15 U.S.C. § 77l (2000).
23. *See* Pinter v. Dahl, 486 U.S. 622 (1988); Ryder International Corp. v. First American Nat'l Bank, 943 F.2d 1521 (11th Cir. 1991).
24. Gustafson v. Alloyd Co. Inc., 513 U.S. 561 (1995).
25. O.C.G.A. §§ 10-5-12(a) (2000); 10-5-14(a) (2000).
26. O.C.G.A. § 10-5-14(a) (2000).
27. Kirk v. First Nat'l Bank, 439 F. Supp. 1141, 1145 n.1 (N.D. Ga. 1977); Collins v. Norton, 136 Ga. App. 105, 220 S.E.2d 279 (1975).
28. Currie v. Cayman Resources Corp, 595 F. Supp. 1364 (N.D. Ga. 1984), *aff'd in part, rev'd on other grounds*, 835 F.2d 780 (11th Cir. 1988); GCA Strategic Inv. Fund, Ltd. v. Joseph Charles & Assocs., 245 Ga. App. 460, 464, 537 S.E.2d 677, 682 (2000).
29. O.C.G.A. § 10-5-14(a) (2000).
30. *See, e.g.,* Fuller v. Perry, 223 Ga. App. 129, 131, 476 S.E.2d 793, 795 (1996); Oklejas v. Williams, 165 Ga. App. 585, 586, 302 S.E.2d 110, 111 (1983).
31. Simpson Consulting v. Barclays Bank PLC, 227 Ga. App. 648, 651, 490 S.E.2d 184, 188 (1997).
32. O.C.G.A. § 23-2-53 (1982).
33. Hunter, Maclean, Exley & Dunn, P.C. v. Frame, 269 Ga. 844, 848, 507 S.E.2d 411, 414 (1998); *see generally* O.C.G.A. § 23-2-51 to § 23-5-55 (providing a statutory basis for fraud claims).
34. GCA Strategic Inv. Fund, Ltd. v. Joseph Charles & Assocs., 245 Ga. App. 460, 464, 537 S.E. 2d 677, 682 (2000).
35. Bogle v. Bragg, 248 Ga. App. 632, 637, 548 S.E.2d 396, 401 (2001) (noting that the statements were made by an attorney who owed no duty to the investor).
36. Thompson v. Smith Barney, Harris Upham & Co., 709 F.2d 1413, 1416 (11th Cir. 1983); *see also* McNeal v. Paine, Webber, Jackson & Curtis, Inc., 598 F.2d 888, 890 n.1 (5th Cir.1979.
37. *See* Hecht v. Harris, Upham & Co., 430 F.2d 1202, 1206-1207 (9th Cir. 1970); Armstrong v. McAlpin, 699 F.2d 79 (2d Cir. 1983).
38. GA. COMP. R. & REGS. r. 590-4-2-.14(1)(a)(2).
39. O.C.G.A. § 10-5-12(a)(1) (2000) (providing that it is "unlawful for any person . . . [t]o offer to sell or to sell any security in violation of . . . any rule [or] regulation . . . promulgated or issued by the [Georgia Commissioner of Securities].").
40. O.C.G.A. § 10-5-14(a) provides that "[a]ny person [committing an unlawful practice under O.C.G.A. § 10-5-12(a)] shall be liable to the person buying such security."
41. Manela v. Garantia Banking, Ltd., 5 F. Supp. 2d 165, 173 (S.D.N.Y. 1998).
42. *See, e.g.,* Arceneaux v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 767 F.2d 1498, 1501 (11th Cir. 1985).
43. NASD Conduct Rule 2510(b), NASD Sec. Dealers Man. (CCH) R.2510 (2002); NYSE Rule 408(a), 2 N.Y.S.E. Guide (CCH) P2408 (1996). A broker may also be given oral "time and price" discretion to sell a specified quantity of securities. NASD Conduct Rule 2510(d)(1); NYSE 408(d). Unless provided otherwise in writing, such "time and price discretion" is generally understood to be limited to the day it is granted. See, e.g., Hanford v. Marion Bass Securities Corp., NASD No. 98-01422 (August 12, 1999).
44. Pierce v. Richard Ellis & Co., 310 N.Y.S.2d 266, 268 (N.Y. Civ. Ct. 1970).
45. M&B Contracting Corp. v. Dale,

601 F. Supp. 1106,1111 (E.D. Mich. 1984), *aff'd,* 795 F.2d 531 (6th Cir. 1986); *accord* Leib v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 461 F. Supp. 951, 954-55 (E.D. Mich. 1978), *aff'd,* 647 F.2d 165 (6th Cir. 1981); Nunes v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 635 F. Supp. 1391, 1393-94 (D. Md. 1986).

46. Moran v. Kidder Peabody & Co., 609 F. Supp. 661, 666 (S.D.N.Y. 1985), *aff'd,* 788 F.2d 3 (2d Cir. 1986); *see also* Freundt-Alberti v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 134 F.3d 1031 (11th Cir. 1998).
47. *See, e.g.,* In re Thomson McKinnon Securities, Inc., 191 B.R. 976, 983-84(Bankr. S.D.N.Y. 1996) (finding that a turnover rate of 2.22 creates a question of fact for a jury to decide if activity was excessive).
48. *See, e.g.,* Thompson v. Smith Barney, Harris Upham & Co., 539 F. Supp. 859 (N.D. Ga. 1982), *aff'd,* 709 F.2d 1413 (11th Cir. 1983) (Plaintiff who was aware that his options account was being constantly traded, who had financial acumen to determine his own best interests, and who desired frequent trading could not establish excessive trading.)
49. *See, e.g.,* Cmty. Hosp. of Springfield & Clark County, Inc. v. Kidder, 81 F. Supp. 2d 863 (S.D. Ohio 1999).
50. *See, e.g.,* Hecht v. Harris, Upham & Co., 283 F. Supp. 417, 435-36 (N.D. Cal. 1968), *modified on other grounds*, 430 F.2d 1202 (9th Cir. 1970); Mihara v. Dean Witter & Co., 619 F.2d 814, 819 (9th Cir. 1980) (finding that excessive trading was established where, among other facts, fifty percent of the securities were held for less than fifteen days).
51. *See, e.g.,* Smith v. Petrou, 705 F. Supp. 183 (S.D.N.Y. 1989) (noting that commissions generated in the customer's account represented a substantial portion of the broker's income); Stevens v. Abbott, Proctor & Paine, 288 F. Supp. 836 (E.D.Va. 1968) (finding that the registered representative derived 40 percent of his income from commissions from customer's account); Hecht v. Harris, Upham & Co., 283 F. Supp. 417 (N.D. Cal. 1968), *modified on other grounds*, 430 F.2d 1202 (9th Cir. 1970) (noting that commissions earned by the broker on plaintiff's account exceeded the commissions earned on all but 11-14 of the other 8,000-9,000 accounts in that office and amounted to 39 percent of all security commissions generated by the broker).
52. *See, e.g.,* Robertson v. Central Jersey Bank & Trust Co., 47 F.3d 1268, 1275 n.4 (3rd Cir. 1995). ("Diversification is a uniformly recognized characteristic of prudent investment and, in the absence of specific authorization to do otherwise, a trustee's lack of diversification would constitute a breach of its fiduciary obligations."). Commentators agree that it takes at least ten, and usually fifteen to twenty, non-correlated securities to achieve adequate diversification and thereby reduce nonsystematic risk. *See* Edwin J. Elton & Martin J. Gruber, Modern Portfolio Theory and Investment Analysis 31 (3d ed. 1987). "Diversification does reduce risk, and the reduction can be greater, the wider the range of possible investments." William F. Sharpe, Investments 115 (1978).
53. In re Laurie Jones Canady, Securities Exchange Act Rel. No. 41250, 1999 SEC LEXIS 669, *30 n.27 (Securities Exchange Commission Apr. 5, 1999) ("Trading on margin increases the risk of loss to a customer for two reasons. First, the customer is at risk to lose more than the amount invested if the value of the security depreciates sufficiently, giving rise to a margin call in the account. Second, the client is required to pay interest on the margin loan, adding to the investor's cost of maintaining the account and increasing the amount by which his investment must appreciate before the customer realizes a net gain. At the same time, using margin permit[s] the customers to purchase greater amounts of securities, thereby generating increased commissions for [the salesperson].")
54. For example, an advisor representing a client with a concentrated position in one security may recommend the purchase of a put option to protect against a continuing decline in value. The put option fixes the minimum price at which the position can be sold during a specific period of time. Another strategy is to create an "equity collar" using both put and call options, which establishes both a floor on the stock's value, and a cap on future price appreciation.
55. A broker looking to improperly increase his commission may recommend that his customer sell a mutual fund he owns, and purchase a fund offered by a different mutual fund company. Switching can generate significant commissions and sales charges benefiting the broker. Many funds impose a surrender charge, typically one percent, if the fund was not held for a minimum period (usually six months or one year). Every switch is a sale and purchase of securities, so it must pass suitability requirements. Switching may not place the investor in a better mutual fund, and may in fact place the investor in a lesser known, lower-quality fund.
56. NASD Conduct Rule 2310(a), NASD Sec. Dealers Man. (CCH) R. 2310 (2002).
57. Brown v. E.F. Hutton Group, Inc., 991 F.2d 1020, 1031 (2d Cir. 1993).
58. Ga. Comp. R. & Regs. r. 590-4-2-.14(1)(a)(3).
59. O.C.G.A. § 10-5-12(a)(1).
60. *See, e.g.,* NYSE Rule 408, 2 N.Y.S.E. Guide (CCH) P 2408 (1996); NASD Conduct Rule 2510, NASD Sec. Dealers Man. (CCH) R.2510 (2002); Glisson v. Freeman, 243 Ga. App. 92, 99 532 S.E.2d 442, 449 (2000); Gochnauer v. A.G. Edwards & Sons, Inc. 810 F.2d 1042, 1049 (11th Cir. 1987).
61. NYSE Rule 408(a); *see also* NASD Conduct Rule 2510, NASD Sec. Dealers Man. (CCH) R. 2510 (2002).
62. Brophy v. Redivo, 725 F.2d 1218, 1220 (9th Cir. 1984); Kayne v. PaineWebber, Inc., 703 F. Supp. 1334, 1340 (N.D. Ill. 1989); Baker v. Wheat First Securities, 643 F. Supp. 1420, 1432 (S.D.W.V. 1986); Bischoff v. G. K. Scott & Co., Inc., 687 F. Supp. 746, 750 (E.D.N.Y. 1986).
63. Ga. Comp. R. & Regs. r. 590-4-2-.14(1)(a)(4).
64. *See, e.g.,* E. F. Hutton & Co. v. Weeks, 166 Ga. App. 443, 445, 304 S.E.2d 420, 422 (1982) ("[T]he broker's duty to account to its cus-

tomer is fiduciary in nature, resulting in an obligation to exercise the utmost goodfaith."); Minor v. E.F. Hutton & Co., 200 Ga. App. 645, 409 S.E.2d 262 (1991). The Securities & Exchange Commission ("SEC") also concludes that the common law of agency, coupled with the rules of the self-regulatory agencies such as the NASD and the NYSE, also give rise to a fiduciary duty owed by brokers. See, 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); accord, Restatement (Second) of Agency § 425 (agents who are employed to make, manage, or advise on investments have fiduciary obligations).

65. *See, e.g.,* Allen v. Lefkoff, Duncan, Grimes & Dermer P.C., 265 Ga. 374, 453 S.E.2d 719 (1995) (finding that the violation of a Bar Rule is not determinative of the standard of care applicable in a legal malpractice action, but it may be a circumstance that can be considered, along with other facts and circumstances, in determining negligence).
66. Securities Exchange Act of 1934, 15 U.S.C. § 78o (b)(4)(E) (2000); *See also* NASD Conduct Rule 3010(b)(1), NASD Sec. Dealers Man. (CCH) R. 3010 (2002); NYSE Rule 405(2), 2 N.Y.S.E. Guide (CCH) P 2405 (1996); GA. COMP. R. & REGS. r. 590-4-2-.08(1).
67. Quick & Reilly, Inc. v. Walker, 1991 U.S. App. LEXIS 5472, at *8 (9th Cir. 1991) (NASD "suitability" rules were relevant to "establish the standard of care to which reasonable broker must adhere," and the jury found broker negligent.); Miley v. Oppenheimer & Co., 637 F.2d 318, 333 (5th Cir. 1981) (Industry rules are "excellent tools against which to assess in part the reasonableness or excessiveness of a broker's handling of an investor's account."); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cheng, 697 F. Supp. 1224, 1227 (D.D.C. 1988) (finding that a violation of a NASD rule provided evidence of broker's negligence); Kirkland v. E.F. Hutton & Co., 564 F. Supp. 427 (E.D. Mich. 1983); Piper, Jaffray & Hopwood, Inc. v. Ladin, 399 F. Supp. 292, 299 (S.D. Iowa 1975) (NYSE and NASD suitability rules "are admissible as evidence of negligence."); Lang v. H. Hentz & Co., 418 F. Supp. 1376, 138384 (N.D. Tex. 1976) (NASD Rules provide evidence of the standard of care that a member should receive.); *see also* O.C.G.A. § 51-1-6 (2000) ("When the law requires a person to perform an act for the benefit of another or to refrain from doing an act which may injure another, although no cause of action is given in express terms, the injured party may recover for the breach of such legal duty if he suffers damage thereby."); O.C.G.A. § 51-1-8 (2000) ("Private duties may arise from statute or from relations created by contract, express or implied. The violation of a private duty, accompanied by damage, shall give a right of action.").
68. *See, e.g.,* Martin v. Shearson Lehman Hutton, Inc., 986 F.2d 242 (8th Cir. 1993).
69. 15 U.S.C. § 78t(a) (2000).
70. *See, e.g.,* Martin v. Shearson Lehman Hutton, Inc., 986 F.2d 242, 244 (8th Cir. 1993); Harrison v. Dean Witter Reynolds, Inc., 79 F.3d 609, 614 (7th Cir. 1996).
71. *See, e.g.,* Hunt v. Miller, 908 F.2d 1210 (4th Cir. 1990).
72. 17 CFR 240.10b-16 (promulgated under the Securities Exchange Act of 1934).
73. *See, e.g.,* Greenblatt v. Drexel Burnham Lambert, Inc., 763 F.2d 1352, 1358 n.8 (11th Cir. 1985); Angelastro v. Prudential-Bache Securities, Inc., 764 F.2d 939, 950 (3rd Cir. 1985); Robertson v. Dean Witter Reynolds, Inc., 749 F.2d 530, 534-39 (9th Cir. 1984); Liang v. Dean Witter & Co., 540 F.2d 1107, 1113 n. 25 (D.C. Cir. 1976). *But see* Bennett v. United States Trust Co., 770 F.2d 308 (2d Cir. 1985) (holding that no private right of action exists under Securities Exchange Act of 1934, Section 7, which controls the amount of money a brokerage firm may lend its customers); Walck v. American Stock Exchange Inc., 687 F.2d 778 (3rd Cir. 1982) (holding that no private cause of action exists for violations of Sections 6 and 7 of the 1934 Act.); Stern v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 603 F.2d 1073 (4th Cir. 1979) (holding that no private right of action exists for violations of Regulation T).
74. For example, the Customer Agreement of a major brokerage firm provides: APPLICABLE LAW, RULES AND REGULATIONS. All transactions shall be subject to the applicable laws, rules and regulations of all federal state and self-regulatory authorities, including, but not limited to, the rules and regulations of the Board of Governors of the Federal Reserve System and the constitution, rules and customs of the exchange or market (and clearing house) where such transactions are executed.
75. O.C.G.A. § 11-1-203 (2002); Jackson Electric Membership Corp. v. Georgia Power Co., 257 Ga. 772, 364 S.E.2d 556 (1988); *see also* Restatement (Second) of Contracts § 205 ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."). *But see* Lake Tightsqueeze, Inc. v. Chrysler First Fin. Servs. Corp., 210 Ga. App. 178, 435 S.E.2d 486 (1993) ("[T]he failure to act in good faith in the performance of contracts or duties under the Uniform Commercial Code does not state an independent claim for which relief may be granted.").
76. 15 U.S.C. § 78t(a) (2000).
77. Harrison v. Dean Witter Reynolds, Inc., 79 F.3d 609, 614 (7th Cir. 1996); *see also* Hollinger v. Titan Capital Corp., 914 F.2d 1564 (9th Cir. 1990) (en banc) (finding control where the primary violator was a registered representative of the firm).
78. O.C.G.A. § 10-5-14(c) (2000).
79. DeBoard v. Schulhofer, 156 Ga. App. 158, 159, 273 S.E.2d 907, 909 (1980).
80. *Id.*
81. Gilbert v. Meason, 137 Ga. App. 1, 5, 222 S.E. 2d 835, 838 (1975); *see also* Hamilton Bank & Trust Co. v. Holliday, 469 F.Supp. 1229, 1244 (N.D. Ga. 1979).
82. O.C.G.A. § 51-2-2 (2000).
83. O.C.G.A. § 10-6-22 (2000).
84. O.C.G.A. § 10-6-21 (2000).
85. O.C.G.A. §10-6-24 (2000).
86. O.C.G.A. §§10-6-25 (2000); 10-6-30 (2000).
87. 18 U.S.C. § 1964(c) (2000).
88. O.C.G.A. § 16-14-3(9)(A)(xxi) (2003). See O.C.G.A. § 10-5-24(a) (2000) (providing that a willful violation of the Act is a felony).
89. O.C.G.A. § 16-14-6(c) (2003) (emphasis added).
90. Taylor v. Bear Stearns & Co., 572 F. Supp. 667, 675 (N.D. Ga. 1983).