

**Public Investors Arbitration Bar Association Report**

**MAJOR INVESTOR LOSSES DUE TO CONFLICTED ADVICE: BROKERAGE  
INDUSTRY ADVERTISING CREATES THE ILLUSION OF A FIDUCIARY DUTY**

**Misleading Ads Fuel Confusion, Underscore Need for Fiduciary Standard**

March 25, 2015

By: Joseph C. Peiffer and Christine Lazaro

## PIABA Report

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### Executive Summary

No national standard exists today requiring brokerage firms to put their clients' interests first by avoiding making profits from conflicted advice. In the five years since the passage of the Dodd Frank Act, inaction by the Securities and Exchange Commission (SEC) on a fiduciary standard has cost American investors nearly \$80 billion, based on estimated losses of \$17 billion per year.

Amid encouraging recent signs of possible action from the Department of Labor and the SEC, there is a compelling case to be made for a ban on conflicted advice in order to protect investors. In the absence of such a standard, brokerage firms now engage in advertising that is clearly calculated to leave the false impression with investors that stockbrokers take the same fiduciary care as a doctor or a lawyer. But, while brokerage firms advertise as though they are trusted guardians of their clients' best interests, they arbitrate any resulting disputes as though they are used care salesmen.

A review by the Public Investors Arbitration Bar Association (PIABA) of the advertising and arbitration stances of nine major brokerage firms – Merrill Lynch, Fidelity Investments, Ameriprise, Wells Fargo, Morgan Stanley, Allstate Financial, UBS, Berthel Fisher, and Charles Schwab – finds that all nine advertise in a fashion that is designed to lull investors into the belief that they are being offered the services of a fiduciary.

For example, Merrill Lynch advertises as follows: "It's time for a financial strategy that puts your needs and priorities front and center." Fidelity Investments appeals to investors with these words: "Acting in good faith and taking pride in getting things just right. The personal commitment each of us makes to go the extra mile for our customers and put their interests before our own is a big part of what has always made Fidelity a special place to work and do business."

Nonetheless, all nine brokerage firms using the fiduciary-like appeals in their ads eschew any such responsibility when it comes to battling investor claims in arbitration. Adding to the confusion is the fact that five of the eight brokerage firms – Ameriprise, Merrill Lynch, Fidelity, Wells Fargo, and Charles Schwab – have publicly stated that they support a fiduciary standard. But these firms are every bit as vociferous as the other four brokerages in denying that they have any fiduciary obligation when push comes to shove in an arbitration case filed by investors who have lost some or all of their nest egg due to conflicted advice.

In this atmosphere of misleading advertising and a complete disavowal by brokerage firms of the same ad claims in arbitration, investor losses will continue to mount at the rate of nearly \$20 billion per year until the SEC and DOL prescribe the long-overdue remedy: a “fiduciary duty” standard banning conflicted advice.

### Introduction

Currently, there is no national standard requiring brokerage firms to put investors’ interest in preserving their nest eggs over brokerage firms’ interest in making money from those investors’ accounts. According to a recent study, every year that goes by without a rule that requires brokers to put investors’ interests first costs American investors another \$17 billion.<sup>1</sup> Dodd-Frank, passed five years ago, mandated that the Securities & Exchange Commission (the “SEC”) study this issue. During the course of the last five years without a SEC rule, inaction on the issue has cost investors nearly **\$80 billion.**<sup>2</sup>

The problem continues to grow worse as more and more Americans lose their defined benefit plans and, instead, roll their life savings into IRAs,<sup>3</sup> which they must invest for their future. A critical component of the problem is the brokerage industry’s marketing efforts to convince investors they absolutely require the assistance of brokers to protect their retirement savings. The Public Investors Arbitration Bar Association (“PIABA”)<sup>4</sup> has a conducted a study to

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<sup>1</sup> See “The Effects of Conflicted Investment Advice on Retirement Savings,” February 2015, available at [http://www.whitehouse.gov/sites/default/files/docs/cea\\_coi\\_report\\_final.pdf](http://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf).

<sup>2</sup> See *id.* \$17 billion times 4.6 years since the passage of Dodd-Frank equals \$79.22 billion.

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<sup>3</sup> Beginning in the 1970s and continuing through the end of 2013, the number of Americans covered by a traditional pension plan was cut in half while the number of Americans depending on 401(k)s and IRAs more than doubled. See “The Effects of Conflicted Investment Advice on Retirement Savings,” February 2015, p.5 available at [http://www.whitehouse.gov/sites/default/files/docs/cea\\_coi\\_report\\_final.pdf](http://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf).

<sup>4</sup> PIABA is a national, not-for-profit bar association comprised of more than 450 attorneys, including law school professors and former regulators, who devote a significant portion of their practice to the representation of public investors in securities arbitration.

determine whether brokerage firms advertise like they have a duty to put investors interests first, but when called to account for their actions, litigate like they have no such duty.

The results are striking. Firms routinely advertise themselves as giving personalized, ongoing, non-conflicted advice that puts the customer first. Brokerage firms have also taken the position publicly with the regulators that such a duty should exist. But, when called to account for their actions, these same brokerage firms litigate like they have no such duty. This highlights the need for a national, strong fiduciary duty that holds firms to the standard they advertise to the public and articulate to the regulators.

The lack of a national fiduciary standard is not just an abstract philosophical question. The lack of such a standard has real-world implications for investors, like Ethel Sprouse. Ms. Sprouse is a baby boomer from Cedar Bluff, Alabama. Her husband suffers from Alzheimer's disease. Her adult daughter is mentally disabled and lives in a group home. Ms. Sprouse and her husband are unsophisticated investors and, like most, entrusted their retirement savings to a trusted financial adviser, who in the Sprouses' case was a registered representative of Allstate Financial ("Allstate"). As her husband's mental capacity and daughter's health diminished, the financial strain on the family increased and Ms. Sprouse's reliance on Allstate to provide her with sound financial advice grew even more crucial. In 2007, the Sprouses transferred all of their life savings to Allstate so that it could be managed by one trusted firm. In short, Allstate used the trust placed in them and invested virtually all of the Sprouses' nest egg into a non-diversified portfolio of stocks, which objectively is very risky and unsuitable for most investors. As a result, Mr. and Mrs. Sprouse lost approximately \$400,000 and the Sprouses sued Allstate in arbitration<sup>5</sup> to recover their losses. The arbitration case is currently pending.

For decades, Allstate's marketing success has been based on the principle that they put their clients' interest first. The "You're In Good Hands" slogan is one of the most prolific in U.S. history. Indeed, while the Sprouses' retirement savings were invested with Allstate, every monthly account statement contained the "Good Hands" recognizable symbol and phrase of trust. However, as illustrated below, when sued, Allstate's legal position is it owed no fiduciary duty to the Sprouses. This report will first review the current landscape of the differing standards of duty that apply to brokerage firms and investment advisors and the SEC and Department of Labor's (DOL) efforts to harmonize those duties. The report then discusses a number of firms' public positions and advertisements regarding their commitment to act in investors' best interest contrasted with their litigation strategy of denying that any such duty

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<sup>5</sup> Allstate included a pre-dispute mandatory arbitration clause in its brokerage agreement with Mr. and Mrs. Sprouse. As result, the Sprouses are unable to seek the help of a court or a jury of their peers, but rather, had no choice other than to file an arbitration administrated by the Financial Industry Regulatory Authority (which is owned by the very brokerage firms customers such as the Sprouses sue) to seek a recovery of their losses.

exists. The report concludes that the SEC and DOL should hold brokerage firms to their public statements and remove all doubt that brokerage firms must put investors' interest first.

### **The Current Landscape: Investment Adviser and Broker Duties**

Investment advice is provided to investors by two different types of financial advisors: Investment Advisers and Brokers. Each is subject to different regulatory regimes, although there is some overlap in those who enforce the regulations. Investment Advisers are subject to the Investment Advisers Act of 1940 (the "Advisers Act") and the rules promulgated thereunder as well as state statutes and regulations. The SEC and the state securities regulators enforce those statutes and regulations. Brokers are governed by the Securities Exchange Act of 1934 (the "Exchange Act") and the rules promulgated thereunder as well as by state statutes and regulations. In addition, Brokers are regulated by the Financial Industry Regulatory Authority ("FINRA"), a self-regulatory organization and are subject to the rules promulgated by FINRA.<sup>6</sup>

Investment Advisers must adhere to a fiduciary duty standard, which is derived from judicial interpretations of the Advisers Act. The fiduciary duty is generally defined by case law to include the duty of loyalty and care, and the obligation to always put the client's interests before and above the Investment Advisor's own interests when the Advisor interacts with a client. Brokers, instead of a fiduciary standard, must adhere to a suitability standard which is premised on a FINRA rule that requires a Broker to have a reasonable basis for believing a recommendation of a security or an investment strategy is "suitable" for a client, based on the client's investment profile.

Although both Investment Advisers and Brokers are regulated extensively, the differences in these regulatory regimes lead to different results for investors. Investors generally are not aware of these differences or their legal implications. Many investors are also confused by the different standards of care that apply to Investment Advisers and Brokers, and many do not even know with which type of investment professional with whom they are doing business. Investors believe their financial advisor, be the title "broker" or "investment adviser," is acting in their best interest. That confusion has been a source of concern for regulators and Congress. Section 913 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") required the SEC to conduct a study to evaluate:

- The effectiveness of existing legal or regulatory standards of care (imposed by the Commission, a national securities association, and other federal or state authorities) for

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<sup>6</sup> Both brokers and investment advisers are subject to the various states' common law regarding the imposition of fiduciary duty. The patchwork of inconsistent state laws on the subject only serves to highlight the critical need for a national standard.

providing personalized investment advice and recommendations about securities to retail customers; and

- Whether there are legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care for providing personalized investment advice about securities to retail customers that should be addressed by rule or statute.<sup>7</sup>

### **Proposed Changes**

In January 2011, the Staff of the SEC issued its report to Congress following the study it conducted pursuant to section 913 of Dodd-Frank. The Staff made the following recommendation:

The Commission should engage in rulemaking to implement the uniform fiduciary standard of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers. Specifically, the Staff recommends that the uniform fiduciary standard of conduct established by the Commission should provide that:

the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide), shall be to act in the best interests of the customer without regard to the financial or other interests of the broker, dealer, or investment adviser providing the advice.<sup>8</sup>

The Staff interpreted this uniform fiduciary standard to encompass the duties of loyalty and care as interpreted and developed under the Advisers Act Sections 206(1) and 206(2).<sup>9</sup>

Between 2011 and 2013, the SEC did not issue any rules in furtherance of the Staff's recommendations. Instead, in March 2013, two years after the staff recommendation, the SEC sought further data and other information, noting it had not yet decided whether to commence rulemaking.<sup>10</sup>

### **SEC Commissioner Perspectives**

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<sup>7</sup> See "Study on Investment Advisers and Broker-Dealers," Executive Summary, p. i, January 2011, available at <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>.

<sup>8</sup> See "Study on Investment Advisers and Broker-Dealers," pp. 109 – 110, January 2011, available at <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>.

<sup>9</sup> See *id.* at p. 111.

<sup>10</sup> See "Duties of Brokers, Dealers, and Investment Advisers," SEC Release No. 34069013, p. 9, available at <http://www.sec.gov/rules/other/2013/34-69013.pdf>.

PIABA believes that the SEC should commence rule-making immediately, clarifying the existence and extent of the fiduciary duty and thereby holding brokerage firms to the standards of conduct they advertise to the public. Commissioners White and Aguilar have both expressed support for rulemaking that would stop brokerage firms from marketing like they have a duty to put investors first and litigating like no such duty exists.<sup>11</sup> Commissioner Stein has not clearly articulated her stance on a uniform fiduciary rule, but has expressed support for aligning the interests of brokers and investors, which underlies a part of a uniform fiduciary rule.<sup>12</sup> Commissioners Gallagher and Piwowar have both stated that they believe more study is necessary.<sup>13</sup>

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<sup>11</sup> Chairman White has recently expressed her view on the subject. She recently stated that the SEC should “implement a uniform fiduciary duty for broker-dealers and investment advisers where the standard is to act in the best interest of the investor.”

<http://www.bloomberg.com/news/articles/2015-03-17/sec-will-develop-fiduciary-duty-rule-for-brokers-white-says>

Commissioner Aguilar has been strongly in support of adoption of a fiduciary duty for Brokers: “I am issuing this statement to be clear as to my position — it is in the best interests of investors and our markets for broker-dealers who provide investment advice to be held to the fiduciary standard that is currently applied to investment advisers.” Statement by SEC Commissioner: Statement in Support of Extending a Fiduciary Duty to Broker-Dealers who Provide Investment Advice, May 11, 2010, available at <http://www.sec.gov/news/speech/2010/spch051110laa.htm>.

<sup>12</sup> Commissioner Stein explained her position as follows:

No doubt, disclosure remains the heart of our investor protection regime. But we also know from experience that sometimes it isn't enough – or to put it another way, that it works better under some conditions than others. What are the conditions under which it works best? Basically, where we have done everything we can to align those interests that should naturally be aligned. When interests are aligned, there are fewer incentives to play games, and better results for ordinary investors, who can make straight-forward, smart decisions... On the market participant side, we have professional standards and rules to ensure that investment advisers' and broker-dealers' interests are appropriately aligned – or at least, not misaligned – with the investors they serve... Are our rules in all of these areas perfect? No. Is there a lot to be done and improved? Absolutely. For example, the Commission is in the midst of considering how to better align the interests of broker-dealers with the investors they serve. It's an important area, and I'm looking forward to seeing progress made.

Remarks Before the Consumer Federation of America's 27th Annual Financial Services Conference, December 4, 2014, available at

<http://www.sec.gov/News/Speech/Detail/Speech/1370543593434#.VO5nGfnF8Yk>.

<sup>13</sup> See Remarks at the 2014 SRO Outreach Conference, September 16, 2014, available at

<http://www.sec.gov/News/Speech/Detail/Speech/1370542969623#.VO5lkPnF8Yk>; Remarks at

## **The Department of Labor Action**

The Department of Labor has examined the role Brokers and Investment Advisers play in the management of retirement accounts. In 2010, the DOL proposed a rule under ERISA broadly defining the circumstances under which a person is considered to be a “fiduciary” by reason of giving investment advice to an employee benefit plan or a plan’s participants.<sup>14</sup> The DOL encountered fierce industry opposition from the very brokerage firms that advertise their personalized service, received extensive comments on the rule proposal, and withdrew the proposal in order to conduct further analysis.<sup>15</sup>

The DOL is in the process of reintroducing the rule proposal to require that those providing retirement investment advice act in the best interest of investors.<sup>16</sup> The DOL cited to a study by the White House Council of Economic Advisers to explain the harms faced by investors as a result of conflicted investment advice:

Based on extensive review of independent research, the White House Council of Economic Advisers (CEA) has concluded that conflicted advice causes affected savers to earn returns that are roughly 1 percentage point lower each year (for example, a 5 percent return absent conflicts would become a 6 percent return). As a result, a retiree who receives conflicted advice when rolling over a 401(k) balance to an IRA at retirement will lose an estimated 12 percent of the value of his or her savings if drawn down over 30 years. If a retiree receiving conflicted advice takes withdrawals at the rate possible absent conflicted advice, his or her savings would run out more than 5 years earlier. Since conflicted advice affects an estimated \$1.7 trillion of IRA assets, the aggregate annual cost of conflicted advice is about \$17 billion each year.<sup>17</sup>

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the National Association of Plan Advisors D.C. Fly-In Forum, September 30, 2014, available at <http://www.sec.gov/News/Speech/Detail/Speech/1370543077131#.VO5pJfnF8Yk>.

<sup>14</sup> See “Definition of the Term “Fiduciary,”” 29 CFR Part 2510, available at <http://webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=24328>.

<sup>15</sup> See Department of Labor, “FAQs: Conflicts of Interest Rulemaking,” available at <http://www.dol.gov/featured/ProtectYourSavings/faqs.htm>.

<sup>16</sup> See Department of Labor, “FAQs: Conflicts of Interest Rulemaking,” available at <http://www.dol.gov/featured/ProtectYourSavings/faqs.htm>.

<sup>17</sup> See Department of Labor, “FAQs: Conflicts of Interest Rulemaking,” available at <http://www.dol.gov/featured/ProtectYourSavings/faqs.htm>. See also “The Effects of Conflicted Investment Advice on Retirement Savings,” February 2015, available at [http://www.whitehouse.gov/sites/default/files/docs/cea\\_coi\\_report\\_final.pdf](http://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf).

The DOL has submitted the rule proposal to the OMB's Office of Information and Regulatory Affairs ("OIRA") for a standard interagency review, after which it will publish a "Notice of Proposed Rulemaking" ("NPRM").

**Brokerage Firms Advertise Like They Offer Ongoing Personalized Service That Puts the Investor First, But Deny Any Such Duty When Called To Account For Their Actions**

There is a striking difference between the positions brokerage firms take when soliciting customers and those they take when those customers arbitrate claims against the same firms. Set forth below are various firms' proclamations to the public set forth in advertisements contrasted with those firms' arguments set forth to FINRA arbitrators. On one hand, the firms boast that they offer unconflicted, trustworthy advice while, on the other hand, those same firms argue they are little more than salesmen with a single duty: to execute trades in customers' accounts.

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**ALLSTATE**

**Allstate Tells The Public That Investors are "In Good Hands."**



The Allstate slogan "You're in good hands" was created a half century ago by Allstate Insurance Company's sales executive David Ellis to demonstrate Allstate's ongoing commitment to customers. The phrase came to him as the result of a reassuring remark made to his wife during the Spring of 1950 about their ailing child. She told him, "The hospital said not to worry. We're in good hands with the doctor." A study announced in September 2000 by Northwestern

University's Medill Graduate Department of Integrated Marketing Communications found that the Allstate slogan "You're in good hands" ranked as the most recognizable in America.<sup>18</sup>

Ethel Sprouse trusted Allstate and its financial adviser. She believed that they were required to put her interests first. Indeed, while Allstate managed the Sprouses' retirement savings, every monthly account statement contained the above illustrated recognizable symbol and phrase of trust.

### **Allstate Tells Arbitrators That Good Hands Owe No Fiduciary Duty**

Notwithstanding Allstate's famous slogan, when Ms. Sprouse sued Allstate in FINRA arbitration after her trusted Allstate financial advisor breached their trust relationship and lost approximately \$400,000 of the Sprouses' life savings, Allstate raised the defense that "Allstate Financial Services owed no fiduciary duty to Claimants, and, therefore, no such duty was breached."<sup>19</sup>

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## **UBS**

### **UBS Tells The Public That the Client Comes First**

"Until my client *knows* she comes first. Until I understand what drives her. And what slows her down. Until I know what makes her leap out of bed in the morning. And what keeps her awake at night. Until she understands that I'm always thinking about her investment. (Even if she isn't.) Not at the office. But at the opera. At a barbecue. In a traffic jam. Until her ambitions feel like my ambitions. Until then. We will not rest. UBS." (Emphasis in advertisement.)<sup>20</sup>

### **UBS Tells Regulators That The Client Does Not Come First**

UBS, like many other firms, ignores the representations in its advertising when it is forced to defend its actions. "[A] broker does not owe a fiduciary duty to his customer in a non-discretionary account."<sup>21</sup>

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<sup>18</sup> See <http://www.adslogans.co.uk/site/pages/gallery/youre-in-good-hands-with-allstate.8355.php>.

<sup>19</sup> See Ex. 1. Also included in the exhibit is a copy of the Sprouses' Statement of Claim that served as the basis for the Answer.

<sup>20</sup> See Ex. 2.

<sup>21</sup> See Ex. 3.

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## MORGAN STANLEY

### Morgan Stanley Tells The Public That It Provides a Personalized Plan

“Having an intimate knowledge of blue chips and small caps is important. But even more important is an intimate knowledge of you and your goals. Get connected to a Morgan Stanley Financial Advisor and get a more personalized plan for achieving success.”<sup>22</sup>

### Morgan Stanley Tells Arbitrators That Its Personalized Plans Can Put The Firm’s Interests Ahead of Clients’

Despite representing that personalized plans would be used, Morgan Stanley says it will only have a fiduciary duty when the service goes beyond the plan and includes Morgan Stanley taking over the trading in an account on a discretionary basis. “There is no fiduciary duty where, as here, the client maintains a non-discretionary brokerage account.”<sup>23</sup>

“Claimants claim of breach of fiduciary duty fails as a matter of law and should be dismissed in its entirety. Claimant’s claim seeks to impose ‘fiduciary’ obligations and duties on Respondents that only arise in very limited circumstances that do not exist here, i.e. where Respondents are given discretionary trading authority over Claimant’s accounts.”<sup>24</sup>

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## BERTHEL FISHER

### Berthel Fisher Tells The Public That It Maintains the “Highest Standard of Integrity.”

“We are committed to maintaining the highest standards of integrity and professionalism in our relationship with you, our client. We endeavor to know and understand your financial situation and provide you with only the highest quality information and services to help you reach your goals.”<sup>25</sup>

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<sup>22</sup> See Ex. 4.

<sup>23</sup> See Ex. 5.

<sup>24</sup> See Ex. 6.

<sup>25</sup> See <http://www.kevinyaley.com!/CustomPage.cfm?PageID=1&disclaimer=accept>.

**Berthel Fisher Tells Arbitrators That the “Highest Standard of Integrity” Does Not Include a Duty to Put Investors First**

While “highest standard of integrity” certainly sounds like a representation that a clients’ interests will be put first, Berthel Fisher says it does not owe a fiduciary duty to clients. “Respondents deny that they owed fiduciary duties to Claimants.”<sup>26</sup>

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**AMERIPRISE FINANCIAL**

**Ameriprise Financial Tells The Public That Its Advisors are “Ethically Obligated To Act With Your Best Interests At Heart.”**

*“Focus on your dreams and goals*

“Once you’ve identified your dreams and goals, and you and the advisor have decided to work together, you can count on sound recommendations that address your goals. You’ll be able to clearly see and discuss how the actions and decisions you make today will affect your tomorrow. You can expect to hear about the options you have and any underlying factors to consider. Our advisors are ethically obligated to act with your best interests at heart.”<sup>27</sup>

*“Personalized advice and recommendations on an ongoing basis*

“Perhaps the best thing about working with a personal financial advisor is that your financial plan is custom made for you. The financial advisor you choose to work with knows all about you. When and if you experience a life change, your priorities shift or you have a pressing financial question, you can contact your advisor for information and financial advice that’s meaningful to you. You may meet a few times during a year and have several discussions. Your advisor will make every effort to be available to you when needed.”<sup>28</sup>

**Ameriprise Financial Tells Regulators That It Advocates For A Uniform Fiduciary Duty**

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<sup>26</sup> See Ex. 7.

<sup>27</sup> From the Ameriprise Financial website, Our Advisors, “What to expect from an Ameriprise financial advisor,” <http://www.ameriprise.com/financial-planning/ameriprise-financial-advisors/financial-advisor-expectations.asp>, last visited February 25, 2015.

<sup>28</sup> From the Ameriprise Financial website, Our Advisors, “What to expect from an Ameriprise financial advisor,” <http://www.ameriprise.com/financial-planning/ameriprise-financial-advisors/financial-advisor-expectations.asp>, last visited February 25, 2015.

Ameriprise has publicly told the SEC that it supports the imposition of a fiduciary duty on brokers, such as Ameriprise. “Our business has been built on a financial planning model with personalized investment advisory services at its core. Our experience in offering retail advice under the Advisers Act, with its enhanced disclosure requirements and other investor protections, has led us to advocate for a uniform fiduciary standard throughout the recent legislative process and endorse SIFMA’s support of a uniform fiduciary standard of conduct for broker-dealers and investment advisers providing personalized advice about securities to retail clients.”<sup>29</sup>

### **Ameriprise Financial Tells Arbitrators That It Doesn’t Believe this Duty Exists**

Despite its advertising campaign promising to put client interests first and even publicly supporting and acknowledging a belief that a fiduciary duty is required, Ameriprise has nevertheless argued in arbitration it owes no such duty. “Respondent owed no fiduciary duties to Claimants and, even if it did, no such duties were breached.”<sup>30</sup>

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## **MERRILL LYNCH**

### **Merrill Lynch Tells The Public That It Puts Investors “Needs Front and Center”**

“It’s time for a financial strategy that puts your needs and priorities front and center.

“Adapting the approach as life changes and goals are reached. As goals and priorities change, so should your approach.”<sup>32</sup>

“Our organization has all the tools and technology and ease of use that you would want. But ultimately, the real measure is when you sit down with your advisor and build that trusting relationship... and at any time you know exactly where you stand... when you think about progress towards what it is you want to accomplish with your... finances and with your money.

“Our entire company’s purpose is to help you achieve the best life for yourself, and for your family. And this purpose, to making life better extends even further to our communities and beyond. We’re proud of our company. We want you to be proud of it as well, and for you to value your relationship with us.”<sup>33</sup>

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<sup>29</sup> Ameriprise Financial, Inc. Letter to the SEC dated August 30, 2010, available at <http://www.sec.gov/comments/4-606/4606-2640.pdf>.

<sup>30</sup> See Ex. 8.

<sup>32</sup> From the Merrill Lynch website, Working with Us, “From a Conversation to a Relationship,” <https://www.ml.com/life-goals.html>, last visited February 25, 2015.

<sup>33</sup> From the Merrill Lynch website, Working with Us, “From a Conversation to a Relationship,” John Thiel, the head of Merrill Lynch Wealth Management, on what makes working with Merrill

### **Merrill Lynch<sup>34</sup> Tells Regulators That It Supports A Uniform Fiduciary Duty**

“Bank of America supports applying a new, harmonized standard of care to all financial professionals providing personalized investment advice to individual investors. In particular, we believe that both broker-dealers and investment advisers giving personalized investment advice to individual investors should be subject to a fiduciary duty that is clearly prescribed. We further believe that any new fiduciary standard of care should be applied in a manner that both enhances investor protection and preserves the availability of choices for clients. Informed client choice is critical to ensuring that investment objectives are attained.”<sup>35</sup>

### **Merrill Lynch Tells Arbitrators That It Has No Duty to Put Investors “Front and Center”**

Despite marketing that clients’ interest would be “front and center” and a desire to “build a trusting relationship” as well as publicly supporting the imposition of a fiduciary duty, Merrill Lynch has refused to acknowledge it owes a fiduciary duty in arbitration when it breaches that duty to investors. “The Second Circuit ruled that in a non-discretionary securities account, there is no ongoing duty of reasonable care that requires a brokerage firm to give advice or monitor information beyond the limited transaction-by-transaction duties that are implicated in executing its customer’s instructions.”<sup>36</sup>

“Respondents did not stand in a fiduciary relationship with Claimants.”<sup>37</sup>

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## **FIDELITY INVESTMENTS**

### **Fidelity Investments Tells The Public That It Puts Investors’ “Interests Before Our Own”**

**“Acting in good faith and taking pride in getting things just right.** The personal commitment each of us makes to go the extra mile for our customers and put their interests before our own is a big part of what has always made Fidelity a special place to work and do business. With millions relying on us for their savings or the growth of their business, we handle every action and decision with integrity and personal attention to detail. Getting things just right doesn’t mean

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Lynch so different, <https://mlaem.fs.ml.com/content/dam/ML/working-with-us/pdfs/transcript-life-goals-thiel.pdf>, last visited February 25, 2015.

<sup>34</sup> Bank of America purchased Merrill Lynch in the fall of 2008 and Merrill Lynch is therefore now a division of Bank of America Corp.

<sup>35</sup> Bank of America Corp. Letter to the SEC dated August 30, 2010, available at <http://www.sec.gov/comments/4-606/4606-2583.pdf>.

<sup>36</sup> *See Ex. 9.*

<sup>37</sup> *See id.*

we're perfect, but rather setting high standards, refusing to cut corners, and believing that every product, every experience, and every outcome can always be better.”<sup>38</sup>

### **Fidelity Investments Tells Regulators That It Supports A Uniform Fiduciary Duty**

“Fidelity supports a uniform fiduciary duty for broker-dealers and investment advisers that would require broker-dealers and investment advisers to act in the best interest of retail customers when offering personalized investment advice about securities to such retail customers.”<sup>39</sup>

### **Fidelity Tells Arbitrators That It Denies Any Duty To Put Investors' Interests Before Their Own**

Even though Fidelity Investments markets that it will put investors' interests before its own and has publicly supported a fiduciary standard for brokerage firms, Fidelity has argued no such duty exists when defending itself in arbitrations with customers. “Claimants first claim fails because Fidelity did not owe [the investors] any fiduciary duty.”<sup>40</sup>

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## **WELLS FARGO**

### **Wells Fargo Tells The Public That Investors “Feel that Your Best Interests are the Top Priority”**

“**Are we working toward common goals?** A healthy relationship with your Financial Advisor should make you feel that your best interests are the top priority, no matter what is happening in the market and no matter the size of your portfolio. Furthermore, you should like your advisor, and both you and your advisor should feel that all concerns are heard and addressed.”<sup>41</sup>

“**Are we sharing information and asking questions?** Your financial consultant should provide you with the relevant information needed to help you feel informed about financial events that pertain to your investments. Your Financial Advisor may also answer any questions you might

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<sup>38</sup> From the Fidelity Investments website, About Fidelity, “Our Purpose and Standards,” <https://www.fidelity.com/about-fidelity/our-purpose-standards>, last visited February 25, 2015.

<sup>39</sup> Fidelity Investments Letter to the SEC dated July 5, 2013, available at <http://www.sec.gov/comments/4-606/4606-3117.pdf>.

<sup>40</sup> See Ex. 10.

<sup>41</sup> From the Wells Fargo Advisors website, Working With a Financial Advisor, “How to Evaluate a Financial Advisor,” <https://www.wellsfargoadvisors.com/financial-advisor/articles/evaluate-financial-advisor.htm>, last visited February 25, 2015.

have about your monthly statements. Stay in contact to ensure that your advisor is current on your objectives and can make changes when necessary.”<sup>42</sup>

### **Wells Fargo Tells Regulators That It Supports A Uniform Fiduciary Duty**

“Wells Fargo fully supports the adoption of a uniform federal fiduciary duty standard for broker-dealers when providing personalized investment advice regarding securities to retail clients. Properly implemented, such a standard will enhance protections for clients, preserve the opportunities for clients to select the level of service and type of relationship they desire, allow clients of all levels of sophistication and resources to be fully served and foster competition in the industry.”<sup>43</sup>

### **Wells Fargo Tells Arbitrators To Forget About Feelings, The Firm Is Not Required to Consider Investors’ Interest First**

Ignoring that it markets itself as making investors feel their “best interests are the top priority” and that Wells Fargo has even publicly supported the need for a uniform fiduciary duty, in private arbitrations, Wells Fargo has refused to acknowledge owing a fiduciary duty. “The law establishes that a broker does not owe a fiduciary duty to a customer with respect to a non-discretionary account.”<sup>44</sup>

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## **CHARLES SCHWAB**

### **Charles Schwab Tells The Public That Its Brokers Are Proactive**

“For many years, we’ve encouraged investors like you to “Talk to Chuck” so we could help you manage through the array of investing challenges and opportunities. I still encourage you to do that. We’ll share with you our passion for investing and our thoughts on how to do it well, and we’ll listen to you to understand how we can help you reach your goals. But going forward, you’ll be hearing more about the values we stand for and why they might matter to you. Our communications will emphasize the fundamental belief we share with you: a belief that through personal engagement and a relationship of mutual respect, your financial goals and a better tomorrow are within reach.”<sup>45</sup>

“Does my broker discuss the risks in my investment portfolio?”

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<sup>42</sup> *See id.*

<sup>43</sup> Wells Fargo & Co. Letter to the SEC dated August 30, 2010, available at <http://www.sec.gov/comments/4-606/4606-2592.pdf>.

<sup>44</sup> *See Ex. 11.*

<sup>45</sup> From the Schwab website, Why Choose Schwab, “An Open Letter from Chuck,” [http://www.schwab.com/public/file/P-6083252/Chuck\\_Open\\_Letter.pdf](http://www.schwab.com/public/file/P-6083252/Chuck_Open_Letter.pdf), last visited February 25, 2015.

“All investors need to understand the various risks in their investment portfolio and their tolerance level for those risks. But, how much and how often do you discuss these risks with your broker? Is your broker proactive about communicating possible risks as things change in the markets, economy or in your personal situation?”<sup>46</sup>

### **Charles Schwab Tells Regulators That The Customers’ Interests Should Come First**

“Given the narrow area of overlap, the Commission should consider a straight-forward rule, simply tracking the language of Dodd-Frank Section 913(g)(1):

“The standard of conduct” when providing non-discretionary “personalized investment advice about securities to a retail customer” for a commission or other transaction-based compensation is “to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.”<sup>47</sup>

### **Charles Schwab Tells Arbitrators That Customers’ Interests Do Not Come First.**

Even though Charles Schwab told regulators that personalized investment advice provided in exchange for a commission should require the broker to act in the best interest of a customer without regard to the broker’s own financial interest, it takes a very different approach when pleading its case to the arbitrators. “Where a customer maintains a non-discretionary account, a broker-dealer’s duties are quite limited. A broker does not, in the ordinary course of business, owe a fiduciary duty to a purchaser of securities.”<sup>50</sup>

### **Why Wouldn’t Investors Want A Uniform Fiduciary Rule?**

In the above advertisements, brokerage firms consistently acknowledge that investors want, expect and need for brokerage firms to put their interests first. However, when the reality of the imposition of a fiduciary duty is evaluated, broker firms have changed their story and often argued that such a duty would actually harm investors. If some representatives of the brokerage industry are to be believed, the imposition of a national fiduciary duty would result in higher costs for investors and a barrier to low-income investors’ access to brokerage advice. For example, the National Association of Plan Advisors (“NAPA”), a securities industry advocacy group, claims that a “conflict of interest” rule is really a “no advice” rule. In other words, according to NAPA, prohibiting conflicts of interests would “block Americans from working with the financial advisors and investment providers they trust simply because they offer

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<sup>46</sup> From the Schwab website, Own Your Tomorrow, “Stay Engaged Questions,” <http://content.schwab.com/corporate/own-your-tomorrow/#Stay-Engaged-Questions>, last visited February 25, 2015.

<sup>47</sup> Charles Schwab & Co., Inc. Letter to the SEC dated July 5, 2013, available at <http://www.sec.gov/comments/4-606/4606-3137.pdf>.

<sup>50</sup> Ex. 12.

different financial products – like annuities and mutual funds – with different fees.”<sup>51</sup> NAPA continues: “This rule could even restrict who can help you with your 401(k) rollover.” The situation would be particularly dire, according to a 2011 study prepared by Oliver Wyman Inc. in response to the DOL’s first attempt to propose a uniform fiduciary standard.<sup>52</sup> According to the abstract of the report, IRAs are widely held by small investors, who overwhelmingly favor brokerage relationships over advisory ones, and the proposed rule would prohibit 7.2 million current IRAs from receiving investment advice thanks to account minimums.<sup>53</sup> Further, the study claims that costs for brokerage IRA customers would increase between 75% and 195%.<sup>54</sup>

Actual data, as opposed to the rhetoric and hyperbole, demonstrates that the imposition of a fiduciary duty upon brokers has no meaningful impact on cost to investors or access to investment advice.<sup>55</sup> In fact, differences in state broker-dealer common law standards of care have been tested to determine whether a relatively stricter fiduciary standard of care affects the ability to provide services to customers, and it was found that there is no statistical difference in the brokers’ ability to provide services to higher or lower wealth clients, or their ability to provide a broad range of products including those that provide commissioned compensation. There was also no difference in the ability to provide tailored advice. And, perhaps most cuttingly for the industry’s argument – there was no difference in the cost of compliance.

Given that the imposition of a uniform fiduciary rule neither affects access to investment advice nor increases costs, it is clear that the rule stands to benefit investors in a meaningful way by prohibiting conflicted investment advice.

### Conclusion

Billions each year slip through the fingers of American investors because of the conflicted investment advice they receive. The SEC and DOL must take action to force brokerage firms to live up to the standard that they market to investors rather than the one brokerage firms argue when they have wronged those same investors. Brokerage firms advertise that they put customers’ interests first, offer personalized advice and do all of this on an ongoing basis. In other words, they advertise that they are a fiduciary such as a doctor or lawyer. But, when a dispute arises with investors, brokerage firms consistently argue they have the duties of a used

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<sup>51</sup> “White House Rule Could Block 401(k) Participants from Advice,” available at <http://aspanews.org/2015/02/23/white-house-rule-could-block-401k-participants-from-advice/>

<sup>52</sup> The report was submitted to DOL by Davis & Harman LLP on April 12, 2011, on behalf of twelve financial services firms that offer services to retail investors. The cover letter and report can be found at <http://www.dol.gov/ebsa/pdf/WymanStudy041211.pdf>.

<sup>53</sup> *See id.* at p. 2.

<sup>54</sup> *See id.*

<sup>55</sup> Finke, Michael S. and Langdon, Thomas Patrick, *The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice* (March 9, 2012). Available at SSRN: <http://ssrn.com/abstract=2019090> or <http://dx.doi.org/10.2139/ssrn.2019090>.

car salesman. SEC and DOL action for a strong, national fiduciary standard is the only way to protect investors' hard-earned retirement savings by holding firms to the image they themselves present.

## **Appendix of Exhibits**

# **Exhibit 1**

FINANCIAL INDUSTRY REGULATORY AUTHORITY  
OFFICE OF DISPUTE RESOLUTION

In the matter of the arbitration between:

FINRA CASE NO. 14-01272

ETHEL J. SPROUSE, INDIVIDUALLY AND  
AS ATTORNEY-IN-FACT FOR JAMES H.  
SPROUSE, JR., M.D.,

Claimants,

vs.

ALLSTATE FINANCIAL SERVICES, LLC,  
MUTUAL SERVICE CORPORATION AND LPL  
FINANCIAL LLC,  
Respondents.

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**RESPONDENT ALLSTATE FINANCIAL SERVICES, LLC'S  
ANSWER AND AFFIRMATIVE DEFENSES TO STATEMENT OF CLAIM**

Respondent ALLSTATE FINANCIAL SERVICES, LLC ("AFS"), by its undersigned counsel, hereby submits its Answer and Affirmative Defenses to Claimants ETHEL J. SPROUSE, Individually and as Attorney-In-Fact for JAMES H. SPROUSE, JR., M.D. (together, the "Claimants") Statement of Claim. For all of the reasons set forth herein, Claimants' Statement of Claim should be dismissed with prejudice and all relief requested should be denied.

**I. STATEMENT OF ANSWER**

AFS denies the truth of each and every allegation contained in the Statement of Claim. Simply stated, Claimants assert a number of nonspecific and baseless allegations against AFS. Claimants had five (5) separate Accounts at AFS; specifically, Account No. [REDACTED] 8 (Ethel Sprouse, Traditional IRA); Account No. [REDACTED] (Ethel Sprouse, Transfer on Death Account); Account No. [REDACTED] (Ethel Sprouse, Individual Account); Account No. [REDACTED] 6 (J. Henry Sprouse, IRA Account); and Account No. [REDACTED] 0 (J. Henry Sprouse, Transfer on Death Account) (collectively, the "Accounts"). Interestingly, Claimants fail to

specify which of the Accounts they believe were improperly managed or which actually suffered damages.

Notwithstanding the foregoing, it is undisputed that said Accounts were established in or about **December 2005 and January 2006**<sup>1</sup> at AFS. Accordingly, as further set forth herein, all claims against AFS are barred by FINRA's eligibility rule, FINRA Rule 12206, and the applicable statutes of limitations. In addition, what is even more troublesome is the fact that the Accounts maintained at AFS actually suffered very few losses, if any, during the time period that the Accounts were maintained at AFS!

Further, despite what is alleged in the Statement of Claim, while held at AFS, the agent, Patrick Bellantoni ("Bellantoni"),<sup>2</sup> did not act as a "financial advisor" for Claimants. Bellantoni was an independent contractor with AFS. Further, any and all trades in the Accounts were discussed with Claimants before the transactions took place. Bellantoni recommended that Claimants invest their brokerage accounts in a diversified portfolio of growth mutual funds to meet their growth objectives.<sup>3</sup> When Bellantoni left AFS in or about July 2008, Claimants elected to move their Accounts with him and opened new accounts at Respondent Mutual Service Corporation ("MSC"). Bellantoni and Claimants were fully aware that AFS did not allow discretionary trading. Notwithstanding the foregoing, the facts demonstrate that

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<sup>1</sup>The Accounts at issue were originally transferred in-kind from Respondent LPL FINANCIAL LLC ("LPL"), in December 2005 and January 2006.

<sup>2</sup>Ballantoni graduated from the University of Detroit Mercy in 1969 with a BSBA. After serving as an officer in the U.S. Marine Corps, he completed undergraduate and graduate business courses at The Citadel and Georgia State University. He became securities licensed in 1983 and obtained a Certified Financial Planner professional designation in 1986. Among his various other roles in the financial services industry, Bellantoni has served as a FINRA Arbitrator, created a continuing education program for the CFP Board, and is the past president of the Georgia Society of the Institute of Certified Financial Planners and the Georgia Mediators Association. Bellantoni was previously registered with Respondent LPL FINANCIAL LLC ("LPL"), between 2003 and 2005, before being registered with AFS in or about December 2005 until July 2008. He then joined Respondent Mutual Service Corporation ("MSC") until September 2009, when he became registered with LPL as part of an integration with MSC. Bellantoni remained with LPL until retiring in August 2013.

<sup>3</sup>The Accounts at issue, were originally transferred in-kind from LPL, in December 2005 and January 2006.

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Bellantoni's investment decisions were prudent based on Claimants' disclosed investment objectives and risk tolerance. Nevertheless, Claimants now seeks to hold AFS responsible for purported investment losses "in excess of \$400,000," including losses they clearly suffered as a result of the worldwide financial crisis of 2008 and 2009 (again, after Claimants moved their Accounts to MSC). The fact that any of Claimants' investments lost money, however, is not evidence of wrongdoing. Accordingly, Claimants' claims should be denied on this basis alone.

Despite being properly advised as to all features, fees and expenses associated with the Accounts, Claimants now appear with allegations that the Accounts were allegedly improper and unsuitable. Claimants crafted a purposefully vague and misleading claim in hopes of imposing liability on AFS instead of acknowledging their own decisions and regrets.

The evidence will show that Claimants have not suffered any losses, and even if they had, such losses were not the result of any unsuitability, negligence, negligent supervision, breach of contract, or breach of fiduciary duty as alleged in the Statement of Claim. Claimants would have this Arbitration Panel believe that they were totally ignorant of the activity in the Accounts, despite the fact that they clearly received and executed documentation regarding the Accounts, together with monthly account statements ranging from in or about December, 2005 through July, 2008. Furthermore, the Accounts at issue were originally transferred in-kind from Respondent LPL FINANCIAL LLC ("LPL"), in December, 2005 and January, 2006. Accordingly, said Accounts were previously initiated at said institution and certainly, AFS cannot be held responsible for any actions taken by Bellantoni prior to his association with AFS.

Essentially, Claimants seek to have AFS guarantee them against losses for market risks that they assumed just by being invested, and specifically guarantee them against market losses during the 2008 financial decline. Certainly, common sense would dictate otherwise. Further,

FINRA Rules clearly prohibit any such guarantees. Based upon the foregoing, Claimants' Statement of Claim should be dismissed in all respects.

**A. Claimants' Legal Claims.**

Unfortunately, it is hard to discern what specific claims Claimants are raising against AFS. However, it appears that they seek damages for the following "possible" causes of action for: 1) breach of fiduciary duty; 2) breach of contract; 3) negligence; 4) negligent misrepresentation; 5) violation of FINRA rules; 6) suitability; 7) violation of the Georgia Securities Act; 8) respondeat superior; and 9) failure to supervise.

Although attempting to assert these numerous legal claims, this appears to be nothing more than a "kitchen sink" approach. Simply stated, AFS did not breach any duties owed to Claimants, violate any statutes, or make any material misrepresentations. Accordingly, Claimants' Statement of Claim should be dismissed in its entirety.

**B. Claimants' Accounts Were Not Unsuitable.**

Claimants' allegations of unsuitability fail in light of the fact that the Accounts were consistent with Claimants' stated objectives and circumstances. It is well-settled that suitability is determined at the point of sale, based upon the circumstances existing at the time, and not upon the subsequent performance of securities caused by a downturn in the market.

In order to prevail on a suitability claim, Claimants must prove that: (1) the investments were unsuited to Claimants' objectives; (2) AFS knew or reasonably believed that the securities were unsuited to Claimants' needs; (3) AFS *recommended* or purchased the unsuitable securities for Claimants anyway; (4) AFS acted with scienter; and (5) Claimants justifiably relied to their detriment on AFS's allegedly fraudulent conduct. Brown v. E.F. Hutton Group, Inc., 991 F.2d

1020, 1031 (2d Cir. 1993). However, Claimants simply cannot establish these requisite elements.

Additionally, FINRA Rule 2310, Recommendations to Customers (Suitability), states:

(a) In 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 member 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

(b) Prior to the execution of a transaction recommended to a ... customer ... a member shall make reasonable efforts to obtain information concerning:

- (1) the customer's financial status;
- (2) the customer's tax status;
- (3) the customer's investment objectives; and
- (4) such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer.

Thus, Rule 2310 requires that, prior to making a recommendation to a customer, the broker shall make reasonable efforts to obtain information regarding the customer's financial status, tax status, investment objectives and any other reasonable information from the customer. Then, based on that information, the broker must have *reasonable grounds* for believing that his recommendation is suitable for the customer. Here, AFS obtained the required information regarding Claimants. More importantly, any and all recommendations made to Claimants were based on reasonable grounds for believing that such recommendations were suitable for them. Accordingly, the regulatory duties imposed by Rule 2310 were satisfied.

AFS knew its customer, and any allegations to the contrary are without merit. AFS did not engage in any wrongful act or omission in the handling of Claimants' Accounts. Accordingly, Claimants' allegations of unsuitability wholly lack merit. Since AFS should not be held liable for recommendations it did not make, and because Claimants' investments were

consistent with their risk tolerance and objectives, Claimants' attempt to now argue unsuitability must fail in all respects.<sup>4</sup>

**C. AFS Was Not Negligent In Its Dealings With Claimants.**

Claimants make conclusory allegations of negligence, which require them to prove a number of legal elements, including duty, breach, causation and damages. The mere allegation of poor account performance in the Statement of Claim establishes none of these elements and falls far short of establishing a *prima facie* case. Therefore, the Arbitration Panel should dismiss these claims outright, as they are totally unsupported by the facts. In short, AFS was not negligent in its dealings with Claimants.

**D. AFS Cannot be Held Liable for Failure to Supervise.**

AFS unequivocally denies that it failed to supervise Bellantoni. Notwithstanding the foregoing, it is well-established that courts do not recognize a private cause of action for failing to adhere to FINRA rules and regulations. Alberti vs. Stanley, No. 97 CIV. 9385 (RO), 1998 WL 438667, at \*4 (S.D.N.Y. 1998) (upholding NYSE Panel's arbitration award because the respondent successfully established that there was no private right of action for violation of NYSE and NASD rules); First Interegional Equity Corp. vs. OTRA Clearing, Inc., 842 F. Supp. 105, 111 (S.D.N.Y. 1994) (upholding NASD Panel arbitration award because the panel did not ignore "the fact that there is no private cause of action under NASD rules"); Charles R. Mills, Benjamin J. Oxley, and Ronald A. Holinsky, *Liability for Unsuitable Recommendations*, Practising Law Institute (Nov. 5, 2008), available at PLIREF-BDR § 6:14 (Westlaw) ("Courts generally have held that there is no private right of action for violation of the SRO rules [like FINRA]."). Accordingly, Claimants' cause of action fails as a matter of law.

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<sup>4</sup>Clearly, all suitability claims against AFS are barred by FINRA's eligibility rule as further set forth above.  
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**E. AFS Did Not Breach Any Contract with Claimants.**

AFS unequivocally denies that it breached the terms of any alleged contract with Claimants. At all relevant times, AFS performed the obligations required under any and all agreement(s) with Claimants, if any. Claimants have not offered any evidence of AFS' alleged breach of its contractual obligations or other industry rules.

**F. AFS Did Not Breach Any Fiduciary Duty Allegedly Owed to Claimants.**

Claimants allege that AFS breached its fiduciary duty to them. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] Independent Order of Foresters v. Donald, Lufkin & Jenrette, Inc., 157 F.3d 933, 940 (2d Cir. 1998); accord Salzmann v. PSI Secs., Inc., No. 91 Civ. 4253, 1994 WL 191855, at 7 (S.D.N.Y. May 16, 1994) Levitin v. PaineWebber, Inc., 159 F.3d 698, 707 (2d Cir. 1998) (“[A] broker does not, in the ordinary course of business, owe fiduciary duty to a purchaser of securities.”) (internal quotations omitted); Bissell v. Merrill Lynch & Co., 937 F. Supp. 237, 246 (S.D.N.Y. 1996), *aff’d*, 157 F.3d 138 (2d Cir. 1998), and *cert. denied*, 525 U.S. 1144 (1999) (“In the absence of discretionary trading authority delegated by the customer to the broker . . . a broker does not owe a general fiduciary duty to his client.”); Friedman & Co. v. Jenkins, 738 F.2d 251, 254 (8th Cir. 1984) (“Since the account was non-discretionary and controlled by [customer] there is likewise no merit in his contention that an instruction on fiduciary duty should have been given.”). Thus, any claim by Claimants based on a supposed breach of fiduciary duty fails as a matter of law. Investment advice provided incidental to and in connection with a non-discretionary account does not establish a fiduciary duty. Hotmar v.

Lowell H. Listrom & Co., Inc., 808 F.2d 1384 (10th Cir. 1987). As such, AFS owed no fiduciary duty to Claimants, and, therefore, no such duty was breached.

Well-settled law is directly contrary to Claimants' specious assertions. In De Kwiatkowski v. Bear, Stearns & Co., Inc., 306 F. 3d 1293, 1302 (2d Cir. 2002), the Second Circuit Court of Appeals explained that a stockbroker does not have a duty to monitor or manage a non-discretionary account:

[i]t is uncontested that a broker ordinarily has no duty to monitor a nondiscretionary account, or to give advice to such a customer on an ongoing basis. The broker's duties ordinarily end after each transaction is done, and thus do not include a duty to offer unsolicited information, advice, or warnings concerning the customer's investments. A nondiscretionary customer by definition keeps control over the account and has full responsibility for trading decisions. On a transaction-by-transaction basis, the broker owes duties of diligence and competence in executing the client's trade orders, and is obligated to give honest and complete information when recommending a purchase or sale. The client may enjoy the broker's advice and recommendations with respect to a given trade, but has no legal claim on the broker's ongoing attention. [Case citations and parentheticals omitted]. As the district court noted, these cases generally are cast in terms of a fiduciary duty and reflect that a broker owes no duty to give ongoing advice to the holder of a nondiscretionary account.

The giving of advice triggers no ongoing duty to do so.

De Kwiatkowski, 306 F.3d at 1302 (emphasis added) (citations omitted).

Simply put, the Accounts at AFS were not discretionary accounts. As will be demonstrated, AFS complied with each of the applicable duties and responsibilities relating to Claimants' Accounts. Moreover, Claimants cannot establish that their alleged losses were caused by AFS. See Bernstein v. True, 636 So. 2d 1364, 1367 (Fla. 1st DCA 1994) ("Even assuming a breach of fiduciary duty, appellant cannot recover without proof of causation."); see also Schmidt v. Bryant, 312 So. 2d 209, 210 (Fla. 1st DCA 1975). Accordingly, the claim for breach of fiduciary duty lacks merit and should be dismissed with prejudice.

**G. Claimants Cannot Prevail on a Respondeat Superior Theory.**

AFS unequivocally denies that it is liable to Claimants based on the theory of *respondeat superior*. As an initial matter, Claimants misrepresent the relationship between Bellantoni and AFS during the relevant time period. As the evidence will show, at all times material hereto, Bellantoni was an independent contractor for AFS, not an employee. Since a company cannot be held liable through *respondeat superior* for the acts or omissions of an independent contractor, all of Claimants' allegations and claims for relief based upon *respondeat superior* are without merit. See Pulte Home Corp. vs. Am. S. Ins. Co., 647 S.E.2d 614, 619 (N.C. Ct. App. 2007) (“an employer of an independent contractor generally cannot be held vicariously liable for the negligent acts of that independent contractor.”); Freeman vs. Food Lion, LLC, 617 S.E.2d 698, 701 (N.C. Ct. App. 2005) (same). This legal principle is firmly established throughout the country. RESTATEMENT (Third) of Agency § 2.04.

Further, even if this Arbitration Panel believes that AFS is in some way liable through *respondeat superior*, many courts hold that *respondeat superior* does not apply to claims under securities law. See Cent. Bank of Denver, N.A. vs. First Interstate Bank N.A., 511 U.S. 164, 201 n.12 (1994) (Stevens, J., dissenting) (acknowledging the Court's holding that aiding and abetting liability did not exist under securities law and stating that secondary liability based on *respondeat superior* and agency principles was unlikely to survive the majority's ruling); In re: Fidelity/Micron Sec. Litigation, 964 F. Supp. 539, 544 (D. Mass. 1997) (refusing to apply *respondeat superior* to hold defendant liable under plaintiff's 10b-5 claim); Converse vs. Norwood Venture Corp., No. 96 CIV. 3745 (HB), 1997 WL 742534, at \*3 (S.D.N.Y. 1997) (citing Central Bank of Denver, N.A. vs. First Interstate Bank of Denver, 511 U.S. 164 (1994) (dismissing cause of action under Section 10(b) and 10b-5 because “claims based on agency

liability are no longer viable after Central Bank). Once again, any contention of liability based on *respondeat superior* should be dismissed in all respects.

**H. Claimants' Claims are Barred by the Applicable Statutes of Limitations/ Statutes of Repose.**

Although Claimants are intentionally non-specific on what investments they are complaining about and when such investments occurred,<sup>5</sup> Claimants have seemingly put investments made over the entire time period of 2006 through May 2013 at issue in the Statement of Claim. However, as set forth above, Claimants transferred their Accounts to MSC in or about July, 2008. Accordingly, any allegations relating to AFS must relate to actions taken prior to July, 2008. Based upon the foregoing, Claimants' causes of action are time-barred as against AFS.

Claimants inexcusably delayed filing their Statement of Claim until April 22, 2014 – almost six (6) years after they transferred their Accounts to MSC! Claimants assert a claim for alleged violations of the Georgia Securities Act, in addition to various common law claims (breach of fiduciary duty, negligence, breach of contract, and failure to supervise). All of these claims should be denied because they are barred by the applicable statutes of repose and statutes of limitation.

First, the Georgia Securities Act provides a five year repose period from the time the violation occurred. GA. CODE ANN. § 10-5-58(j)(2).<sup>6</sup> Thus, there can be no liability pursuant to the Act for any violation occurring prior to April 22, 2009. This is almost one year after the Accounts were transferred from AFS to MSC. The Act also includes a limitations period of "two years after discovery of the facts constituting the violation." GA. CODE ANN. § 10-5-58(j)(2).

<sup>5</sup>See AFS' Motion to Dismiss above, Section I, incorporated herein.

<sup>6</sup>Certain violations of the Act which might arguably apply to the facts of this case have an even shorter two-year statute of repose. See GA. CODE ANN. § 10-5-58(j)(1).

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If, as Claimants allege, Bellantoni made investments for Claimants that did not comport with their investment objectives, Claimants either discovered, or should have discovered by exercising reasonable care, this purported violation well before filing the Statement of Claim (ie. when Claimants' investments supposedly suffered significant declines). Claimants, however, failed to file their Statement of Claim well after the two-year limitations period had passed. For those investments that suffered declines in 2008, it is also longer than the four-year statute of limitations for Claimants' common law claims. See Almond v. Young, 723 S.E.2d 691, 693 (Ga. Ct. App. 2012) (holding that "[t]he statute of limitations on a fraud claim is four years" under O.C.G.A. § 9-3-31); Kothari v. Patel, 585 S.E. 2d 97, 102 (Ga. Ct. App. 2003) (holding that plaintiffs breach of fiduciary duty claim was a claim for injury to personalty and, thus, was governed by the four year limitations period in O.C.G.A. § 9-3-31).<sup>7</sup> Therefore, Claimants' claims relating to those investments that suffered declines prior to April 22, 2010, are legally barred and should be dismissed.

**I. Claimants' Claims are Barred Pursuant to FINRA's Eligibility Rule, FINRA Rule 12206**

Claimants' claims are barred pursuant to FINRA Rule 12206. FINRA Rule 12206 provides, in pertinent part, that "[n]o claim shall be eligible for submission to arbitration under the Code where six years have elapsed *from the occurrence or event giving rise to the claim.*" Rule 12206 (emphasis added).

As previously set forth above, Claimants fail to specify which of the Accounts they believe were improperly managed or which actually suffered damages. Notwithstanding the

<sup>7</sup>If Claimants are asserting common law claims under Alabama law, the statute of limitations is even shorter. See ALA. CODE § 6-2-38(1); Jones & Kassouf & Co., P.C., 949 So. 2d 136, 139-140 (Ala, 2006) ("Fraud actions are subject to a two year statute of limitations."); Casassa v. Liberty Life Ins., 949 F. Supp. 825, 828 (M.D. Ala. 1996) ("Actions for fraudulent misrepresentation, fraudulent suppression, and breach of fiduciary duty are subject to a two-year statute of limitations, Ala. Code 1975, § 6-2-38").

foregoing, it is undisputed that said Accounts were established in or about **December 2005 and January 2006**. Accordingly, Claimants' allegations are barred by FINRA Rule 12206.

**J. AFS Reasonably Supervised Claimants' Accounts.**

Claimants' claim that AFS did not properly supervise Claimants' Accounts is also baseless. In order to recover on this failure to supervise claim, Claimants must prove that Bellantoni violated the securities laws with respect to the servicing of Claimants' Accounts, and that AFS failed to reasonably supervise with a view toward preventing the violations. Claimants cannot present any such evidence. In fact, the evidence will show that Bellantoni did not commit any securities violations, and that AFS properly trained and supervised Bellantoni with a view toward preventing any securities violations. For these reasons, this claim must be dismissed.

**K. Claimants' Compensatory Damages Amount Are Significantly Overstated.**

Claimants fail to adequately state their damages. Unbelievably, Claimants request a compensatory damages award "in excess of \$400,000," without any factual support for what Claimants' actual investment losses were or how much of those purported losses were the result of AFS' alleged wrongdoing as opposed to unforeseen market events. Based on the timing of those investment losses, however, it is clear that all of Claimants' losses were the result of the financial crisis of 2008. Further, based upon the allegations in the Statement of Claim, it is impossible to segregate the supposed improper actions of the various Respondents. It is undisputed that Claimants left AFS in or about July, 2008 when they moved their Accounts to MSC. Accordingly, AFS cannot possibly be responsible for any losses suffered after the Accounts were transferred.

**II. AFFIRMATIVE DEFENSES**

**AS AND FOR A FIRST  
AFFIRMATIVE DEFENSE**

Claimants fail to state a claim upon which relief can be granted.

**AS AND FOR A SECOND  
AFFIRMATIVE DEFENSE**

The damages for which Claimants seek to hold AFS liable resulted in whole from their own actions or omissions in failing to exercise the degree of care over their affairs and investments, which ordinary, prudent investors would exercise.

**AS AND FOR A THIRD  
AFFIRMATIVE DEFENSE**

Claimants' alleged damages were caused by their own conduct or negligence. In the alternative, Claimants are comparatively negligent by virtue of their own conduct or negligence and, therefore, are precluded from recovery in this action.

**AS AND FOR A FOURTH  
AFFIRMATIVE DEFENSE**

Claimants' alleged damages were caused by the actions and/or inactions of other parties and/or non-parties to this proceeding.

**AS AND FOR A FIFTH  
AFFIRMATIVE DEFENSE**

Claimants were provided all necessary information regarding the Accounts at issue. Claimants failed to act reasonably or diligently under the circumstances. Furthermore, Claimants failed to promptly notify AFS of the alleged acts or omissions of which they are now complaining, and/or failed to promptly notify AFS of same after they discovered or should have discovered the alleged acts or omissions. As a result of Claimants' failure to notify AFS of their objections after receiving documents relating to the Accounts, Claimants are barred from

recovering from AFS under the doctrines of ratification, account stated, estoppel, waiver, statute of limitations, and laches.

**AS AND FOR A SIXTH  
AFFIRMATIVE DEFENSE**

Claimants' demand for damages must be denied on the grounds that they failed to reasonably and/or properly mitigate their damages.

**AS AND FOR A SEVENTH  
AFFIRMATIVE DEFENSE**

Claimants have waived any and all entitlement to relief against AFS.

**AS AND FOR AN EIGHTH  
AFFIRMATIVE DEFENSE**

The applicable statutes of limitation, statutes of repose, and FINRA's eligibility rule, all act as a bar to Claimants' claims.

**AS AND FOR A NINTH  
AFFIRMATIVE DEFENSE**

AFS acted, at all times material hereto, in good faith and in a professional manner.

**AS AND FOR A TENTH  
AFFIRMATIVE DEFENSE**

At all times material hereto, AFS maintained adequate and reasonable supervisory procedures which it reasonably and diligently followed.

**AS AND FOR AN ELEVENTH  
AFFIRMATIVE DEFENSE**

Economic, industry, corporate and market conditions, and not AFS, were responsible for Claimants' losses, if any.

**AS AND FOR A TWELFTH  
AFFIRMATIVE DEFENSE**

The economic loss rule bars all or a part of Claimants' claims.

**AS AND FOR A THIRTEENTH  
AFFIRMATIVE DEFENSE**

AFS's duties to Claimants were limited to transactional duties. Claimants always made the decision to purchase the Accounts they now want to repudiate.

**AS AND FOR A FOURTEENTH  
AFFIRMATIVE DEFENSE**

AFS did not fail to make any relevant or material disclosure of fact to Claimants. Any alleged omissions or misstatements of fact purportedly made by AFS were not relied upon by Claimants, and to the extent such statements may have been relied upon, such reliance was not reasonable in light of the surrounding circumstances.

**AS AND FOR A FIFTEENTH  
AFFIRMATIVE DEFENSE**

No recovery may be had by Claimants in this case, as the damages are purely speculative and without sufficient basis. As a matter of law, such damages are not compensable.

**AS AND FOR A SIXTEENTH  
AFFIRMATIVE DEFENSE**

Claimants and persons/entities that are not parties to this proceeding are at fault and damages, if any, must be apportioned accordingly.

**AS AND FOR A SEVENTEENTH  
AFFIRMATIVE DEFENSE**

At all times material hereto, AFS acted in accordance with Claimants' instructions and the purchase of the Accounts at issue was subsequently confirmed by Claimants.

**AS AND FOR AN EIGHTEENTH  
AFFIRMATIVE DEFENSE**

The handling of Claimants' Accounts was in accordance and in compliance with the applicable brokerage industry standards and guidelines and all regulatory requirements.

**AS AND FOR A NINETEENTH  
AFFIRMATIVE DEFENSE**

The damages suffered by Claimants, if any, were contributed to by conditions or events beyond the control of AFS and AFS is not liable for said damages.

**AS AND FOR A TWENTIETH  
AFFIRMATIVE DEFENSE**

Claimants are barred from any recovery against AFS because Claimants had written notice of and ratified the purchase of the Accounts at issue.

**AS AND FOR A TWENTY-FIRST  
AFFIRMATIVE DEFENSE**

Claimants failed to use due diligence in monitoring their financial affairs, which failure estops Claimants from maintaining this action.

**AS AND FOR A TWENTY-SECOND  
AFFIRMATIVE DEFENSE**

Claimants cannot recover from AFS because AFS did not intend to deceive or defraud Claimants and did not act with “scienter” or in a reckless or negligent manner. AFS acted in good faith relying on Claimants’ representations and Claimants’ lack of complaint concerning any of the activity at issue.

**AS AND FOR A TWENTY-THIRD  
AFFIRMATIVE DEFENSE**

Any injury or loss or damage to Claimants is the result of superseding or intervening causes beyond the control of AFS.

**AS AND FOR A TWENTY-FOURTH  
AFFIRMATIVE DEFENSE**

Claimants are not entitled to recovery herein since they fully understood the nature and consequences of the Accounts at issue.

**AS AND FOR A TWENTY-FIFTH  
AFFIRMATIVE DEFENSE**

Claimants' claim for negligence fails to state a cause of action since such an action cannot be based upon a breach of contract.

**AS AND FOR A TWENTY-SIXTH  
AFFIRMATIVE DEFENSE**

Claimants authorized, directed, and ratified all of the transactions in the Accounts.

**AS AND FOR A TWENTY-SEVENTH  
AFFIRMATIVE DEFENSE**

To the extent Claimants assert that AFS made misrepresentations and omissions, these claims fail for any or all of the following reasons: (1) AFS made no misrepresentations or omissions of material fact; (2) any statements about the investments' expected performance are nothing more than a statement of opinion, which cannot form the basis of liability; and (3) Claimants did not actually rely on any misrepresentations or omissions.

**AS AND FOR A TWENTY-EIGHTH  
AFFIRMATIVE DEFENSE**

To the extent any material risks were not disclosed, they were reasonably unforeseeable.

**AS AND FOR A TWENTY-NINETH  
AFFIRMATIVE DEFENSE**

To the extent Claimants seek to assert claims for alleged violations of NASD, FINRA, or NYSE rules, no such private right of action exists to pursue such claims.

**AS AND FOR A THIRTIETH  
AFFIRMATIVE DEFENSE**

Claimants are not entitled to punitive damages under applicable laws as they fail to state a cause of action that would allow the Arbitrators to grant this type of award.

**AS AND FOR A THIRTY-FIRST  
AFFIRMATIVE DEFENSE**

Claimants' damages are subject to appropriate reduction or set off by the amount of income they received.

**AS AND FOR A THIRTY-SECOND  
AFFIRMATIVE DEFENSE**

Claimants cannot establish the requisite "scienter" on the part of AFS.

**CONCLUSION**

For all the foregoing reasons, AFS respectfully requests that the Statement of Claim be dismissed in its entirety, that all forum fees and costs be assessed solely against Claimants, that the Arbitration Panel make an affirmative finding that AFS is the prevailing party, thereby permitting AFS to seek a determination of entitlement and amount of an award of attorneys' fees for defending this baseless arbitration, together with such other and further relief as is deemed just and proper.

**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that the foregoing has been furnished via Electronic Mail upon: **Steeve Encaoua, Case Administrator**, [Steeve.Encaoua@FINRA.org](mailto:Steeve.Encaoua@FINRA.org), FINRA Dispute Resolution, Boca Center Tower 1, 5200 Town Center Circle, Suite 200, Boca Raton, FL 33486-1015; **Samuel T. Brannan, Esq.**, [stbrannan@dossfirm.com](mailto:stbrannan@dossfirm.com), The Doss Firm, LLC, 36 Trammell Street, Suite 101, Marietta, GA 30064 and **Thomas F. Barnett, Esq.**, [Thomas.barnett@lpl.com](mailto:Thomas.barnett@lpl.com), LPL Financial LLC, 75 State Street, 24<sup>th</sup> Floor, Boston, MA 02109 this 5th day of August, 2014.

KOPELOWITZ OSTROW P.A.

/s/ Samantha Tesser Haimo

Jan Douglas Atlas

Florida Bar Number: 226246

Samantha Tesser Haimo

Florida Bar Number: 148016

200 S.W. 1st Avenue, Suite 1200

Fort Lauderdale, Florida 33301

Telephone: (954) 525-4100

Facsimile: (954) 525-4300

Attorneys for Respondent

Allstate Financial Services, LLC

FINRA ARBITRATION

-----X  
ETHEL J. SPROUSE, Individually and as  
Attorney-in-Fact for JAMES H. SPROUSE, JR., M.D.

Claimants,

- against-

FINRA Case No. \_\_\_\_\_

ALLSTATE FINANCIAL SERVICES LLC,  
MUTUAL SERVICE CORPORATION, and  
LPL FINANCIAL LLC,

Respondents.

-----X

STATEMENT OF CLAIM

Claimant Ethel J. Sprouse, individually and as attorney-in-fact for James H. Sprouse, Jr., M.D., hereby requests arbitration before FINRA Dispute Resolution of disputes arising out of the handling of the Sprouses' accounts by member firms Allstate Financial Services LLC ("Allstate"), Mutual Service Corporation ("Mutual"), and LPL Financial Services LLC ("LPL"), collectively referred to as Respondents.

I. SUMMARY OF CLAIM

The Sprouses bring this claim to recover losses sustained as a result of Respondents' mismanagement of the their accounts. The accounts at issue were discretionary accounts pursuant to which Respondents had a full-fledged fiduciary duty to manage and monitor in accordance with the Sprouses' investment needs and risk tolerance. These accounts held 100% of the Sprouses' liquid net worth. As set

forth below, each Respondent was negligent and reckless and breached its fiduciary duty in this case by pursuing investment strategies and investments that were not aligned with the Sprouses' investment needs and risk tolerance, and in failing to monitor and manage the accounts as a prudent investment manager should. As a result of Respondents' wrongdoing, the Sprouses lost in excess of \$400,000 of their irreplaceable investment assets.

Respondents' actions and omissions in this case violated, among other state securities acts, the Georgia Securities Act and rules promulgated pursuant thereto, and further constitute breach of fiduciary duty, breach of contract, negligence, negligent misrepresentation, and violation of FINRA rules.

## II. PARTIES

(A) CLAIMANTS - The Sprouses are public investors. They reside in Alabama. Ethel Sprouse is 68 years old. Her husband, Dr. Sprouse, is 83 years old, and suffers from Alzheimer's disease.

The Sprouses have elected to proceed under the composition rules for the optional All Public Panel.

(B) RESPONDENTS - Each Respondent is a FINRA member, a licensed broker-dealer, and a registered investment advisor.

(C) PATRICK BELLANTONI - Each respondent conducted business with the Sprouses by and through their registered representative and investment adviser representative Patrick L. Bellantoni (CRD # 1164540). At all times relevant hereto, Mr. Bellantoni resided and conducted his investment advisory business with the Sprouses

in the metropolitan Atlanta area of Georgia. At all times relevant hereto, Mr. Bellantoni was the Sprouses' portfolio manager and managed their accounts with Respondents on a discretionary basis. Accordingly, Mr. Bellantoni had the discretion to buy, sell, hold, exchange, redeem and otherwise trade the Sprouses accounts in accordance with their investment needs and risk tolerance.

### III. FACTS

Ethel Sprouse has worked as a residential real estate appraiser since 1994, but she has not worked much since 2007 due to the real estate market decline. James Sprouse is a retired medical doctor; he retired in 1994.

The relevant time period for this claim is 2008 through May 2013. According to Mr. Bellantoni's CRD, he was associated with Allstate from January 2005 to July 2008, Mutual Service Corporation from July 2008 to September 2009, and LPL from September 2009 to August 2013.

Mr. Bellantoni was a long-time personal friend of the Sprouses, particularly of Dr. Sprouse. Dr. Sprouse had retired from the practice of medicine in 1994. In late 2007 or early 2008, Dr. Sprouse began to experience symptoms of memory loss and dementia. Beginning at that time, Mr. Bellantoni began calling Mrs. Sprouse instead of Dr. Sprouse regarding their investment accounts. By 2008, Mr. Bellantoni knew or should have known that Dr. Sprouse had some mental impairment.

In 2009, Dr. Sprouse was diagnosed with Alzheimers, and Mrs. Sprouse informed Mr. Bellantoni that she had power of attorney for her husband. These facts constituted a significant change of circumstances that required Mr. Bellantoni and

Respondents to reassess the Sprouses' investment needs and risk tolerance, and to adjust their portfolio toward the safer end of the risk spectrum.

In 2008, Dr. Sprouse was 76 years old, had been retired for 14 years and suffered from dementia. Mrs. Sprouse was 62. Neither of them had any significant investment experience except through Mr. Bellantoni. The Sprouses relied on Mr. Bellantoni as their investment manager, and Mr. Bellantoni maintained control of their accounts, exercising his discretion in managing them. The Sprouses made regular monthly withdrawals of \$3,500 after Dr. Sprouse got sick. Prior to that they had regularly withdrawn \$3,000 per month.

At this stage of their lives, and with Dr. Sprouse's deteriorating mental impairment, the Sprouses needed stable investments that produced reliable income. Mr. Bellantoni had a fiduciary duty to provide such investments in managing their investment portfolio; however, the portfolio he constructed was unsuitably volatile for the Sprouses.

One reason for that volatility was the asset allocation, which was overconcentrated in equity securities and other higher risk securities. As of May 2008, the Sprouses' combined brokerage accounts were worth approximately \$1.8 million. During 2008 and 2009, approximately 90% of the Sprouses' portfolio was invested in equities. By the end of 2009, the Sprouses' combined accounts were worth approximately \$1.2 million. The Sprouses' portfolio declined approximately \$600,000 because of Mr. Bellantoni's unsuitably high percentage of equity securities in their accounts, during a time when Mr. Bellantoni knew or should have known that Dr.

Sprouse suffered from dementia, that the Sprouses depended on their investments to produce income to pay their living expenses, and that they had no realistic likelihood of recovering from investment losses.

In 2010, approximately 60% of the Sprouses' portfolio was invested in foreign and emerging markets bonds (which are high risk securities), approximately 35% was invested in asset allocation funds (in which the allocation of stocks and bonds was variable), and approximately 5% was in cash or cash equivalents. By the end of 2010, the Sprouses' combined accounts were worth approximately \$963,504 – down more than \$200,000 from 2009.

In 2011, Mr. Bellantoni apparently outsourced the management of the Sprouses' portfolio to various third party portfolio managers. At this time, we do not have all of the statements, but the allocation to equities and other risky assets classes appears to be over 60%. By the end of 2011, the Sprouses' combined accounts were worth approximately \$879,382 – down another \$84,122 from 2010.

At this time, we do not have all of the statements for 2012, but by the end of 2012, approximately 38% of the Sprouses' portfolio was invested in equities, 4% in was invested in foreign bonds, and 58% was in U.S. fixed income. At the end of 2012, the Sprouses' combined accounts were worth approximately \$840,386 – down another 38,996 from 2011.

At this time, we do not have all of the statements for 2013. In May 2013, the Sprouses' portfolio was transferred away from LPL and Mr. Bellantoni. As of March 2013, the Sprouses' combined accounts were worth approximately \$848,595.

In summary, instead of investing the Sprouses' assets in accordance with their need for stable, income producing investments, Respondents invested those assets in an aggressive portfolio of volatile securities. By May of 2013, the Sprouses' investment losses were in excess of \$400,000. By comparison, the Vanguard Balanced Index fund, a moderate risk portfolio of approximately 60% stocks and 40% bonds, gained approximately 43% over the same time period.

#### IV. WRONGFUL CONDUCT

Respondents breached their fiduciary duty to prudently manage the Sprouses' assets in accordance with their investment needs and risk tolerance. In addition, Respondents' investments made on behalf of Claimants were careless, and they were unsuitable and based on the misrepresentation and omission of material risks in violation of law. Respondents misrepresented to Claimants that the subject investments were suitable for them.

Based upon the foregoing facts, Respondent's misconduct detailed above violated the anti-fraud provisions of the Georgia Securities Act, and thereby gives rise to a claim for damages under the Georgia Securities Act, including attorney's fees, interest and costs, which are mandatory. Respondents' misconduct also violated other state securities acts.

The same misconduct also constitutes breach of fiduciary duty. At all times relevant hereto, Respondents were in a special and fiduciary relationship with the Sprouses by virtue of their discretionary management of the Sprouses' investment accounts. It is axiomatic that "a general fiduciary duty arises if a broker has discretion

over its customers' accounts," *Cooper v. Pacific Life Ins. Co.*, 229 F.R.D. 245, 256 n. 16 (S.D.Ga. 2005), as Respondents did in this case. "It is only with a discretionary account that the broker becomes *a full-fledged fiduciary* of the customer." *Prudential Bache Sec., Inc. v. Pitman*, 1991 WL 160039, \*4 (N.D.Ga., Apr. 4, 1991) (emphasis added). See also *Gochmauer v. A. G. Edwards & Sons, Inc.*, 810 F.2d 1042, 1049 n. 9 (11th Cir. 1987) (In a discretionary account, "the broker has a continuous obligation to manage the account").

In the case at hand, Respondents failed to properly manage the Sprouses' accounts by failing to align the portfolio risk, which was high, with the Sprouses' risk tolerance, which was low, and by failing to act diligently to learn and act upon the significant market risk inherent in the securities Respondents purchased in the Sprouses' accounts.

Respondents' misconduct also constitutes negligence, negligent misrepresentation, breach of contract, and breach of duty (including Respondents' express undertakings to abide by FINRA and NYSE rules).

Respondents are responsible for their own wrongs and, under the doctrine of *respondent superior*, are liable for the acts and omissions of their employees and agents, including Mr. Bellantoni, who at all times was in a special and fiduciary relationship with the Sprouses. Respondents are also liable for their failure to supervise Mr. Bellantoni.

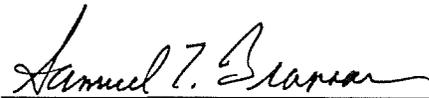
V. DAMAGES

Claimants seek damages, including well-managed account damages<sup>1</sup>, in an amount in excess of \$400,000. In addition to these compensatory damages, Claimants also seek interest on the claims from the time they accrued, punitive damages in an amount determined by the panel, the costs of this proceeding, and reasonable attorneys fees.

Claimants hereby request a hearing of this dispute before an all-public panel in Atlanta, Georgia.

Respectfully submitted this 22<sup>nd</sup> day of April, 2014.

THE DOSS FIRM, LLC



Jason R. Doss  
Samuel T. Brannan  
Attorneys for Claimants

36 Trammell Street, Suite 101  
(770) 578-1314 Telephone  
(770) 578-1302 Facsimile

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<sup>1</sup> "An appropriate measure of damages when an investment advisor is liable for the improper management of an investor's funds is 'the difference between what he would have had if the account [had] been handled legitimately and what he in fact had at the time the violation ended.'" *Perkins v. American International Specialty Lines Ins. Co.*, 2012 WL 2105908, \*26 (Apr. 3, 2012, N.D.Ga.) (citing *Miley v. Oppenheimer & Co., Inc.*, 637 F.2d 318, 327 (5<sup>th</sup> Cir. 1981)).

**FINRA ARBITRATION**

-----X  
**ETHEL J. SPROUSE, Individually and as  
Attorney-in-Fact for JAMES H. SPROUSE, JR., M.D.**

**Claimants,**

**- against-**

**FINRA Case No. 14-01272**

**ALLSTATE FINANCIAL SERVICES LLC,  
MUTUAL SERVICE CORPORATION, and  
LPL FINANCIAL LLC,**

**Respondents.**

-----X  
**CLAIMANTS' MORE DEFINITE STATEMENT OF CLAIM**

In accordance with the Panel's Order, Claimants submit their More Definite Statement of Claim by incorporating herein by reference their original Statement of Claim in its entirety, and adding thereto the following:

Ms. Sprouse's daughter suffers from a mental disability. She is, and at all relevant times was, unable to care for herself and lived in a group home. She is/was a dependent for all practical purposes. In 2006, this daughter had a carcinoid tumor removed from her one of her lungs. This necessitated Ms. Sprouse's traveling to Birmingham on a weekly if not daily basis.

At about the same time, Dr. Sprouse was exhibiting symptoms of early stage Alzheimer's disease. These symptoms included disorientation and repeating himself, asking the same question over and over again, etc. During this time period, the Sprouses had in-person meetings with Mr. Bellantoni during which it had to have been very clear that Dr. Sprouse was exhibiting symptoms of some form of dementia or diminished capacity.

In 2007, Dr. Sprouse's diminished capacity had advanced to a point where it was too much of a burden on Dr. and Ms. Sprouse to have their retirement savings divided between Fidelity and Allstate. As a result of the trust Dr. Sprouse had in Mr. Bellantoni, Dr. Sprouse insisted that Ms. Sprouse's funds at Fidelity be transferred to Allstate and placed under the control of Mr. Bellantoni. Mr. Bellantoni represented to Ms. Sprouse that investments held at Fidelity could not be transferred to Allstate, but rather had to be liquidated at Fidelity and new investments purchased at Allstate.

Thus, in February, 2007, Respondent Allstate recommended and encouraged Ms. Sprouse to liquidate her account at Fidelity in the amount of approximately \$968,270.48 and transfer the funds to Allstate. During this time period, Ms. Sprouse repeatedly told Mr. Bellantoni that, given the deteriorating health of her husband and daughter, she could not afford to lose any money, and that she wanted the Sprouses' money to be invested

conservatively. Ms. Sprouse told Mr. Bellantoni that an annual return of 3% to 5% would be good as long as that could be achieved without a decline in principal.

Mr. Bellantoni misrepresented to Ms. Sprouse that the portfolio he created for her was conservative when in fact it was highly risky and inappropriate for her income oriented goals. For example, as of the end of January 2008, Ms. Sprouse's account ending in [REDACTED], which is the account into which the Fidelity money was transferred in February 2007, was composed of 95.27% equities that declined in value over time. By contrast, the asset allocation in the Fidelity account from which the securities were transferred in to Allstate was approximately 60% equities, 35% bonds and 5% cash or cash equivalents.

In addition, the improper allocation in account ending in [REDACTED] made the allocation in accounts ending in [REDACTED] even more inappropriate given the change in circumstances described above. Despite the fact that Mr. Bellantoni's recommendations were inappropriate, between February 2007 and the time when the Sprouse's investments were transferred out from Allstate, Mr. Bellantoni continued to represent to Ms. Sprouse that their investment portfolio was safe when it was not.

Among other things, Claimants expect that the evidence will show that:

(1) The relationship between the Sprouses and Mr. Bellantoni was fiduciary in nature.

(2) The Sprouses reposed complete trust and confidence in Mr. Bellantoni, and relied on him to make appropriate investment decisions for them.

(3) Mr. Bellantoni and the Sprouses agreed and understood that Mr. Bellantoni would manage their accounts on a discretionary basis.

(4) Mr. Bellantoni undertook to manage the Sprouses' accounts on a discretionary basis (notwithstanding Allstate's assertion that its policy was not to permit discretionary accounts).

(5) The Sprouses repeatedly told Mr. Bellantoni that they were conservative investors, and that they needed and wanted their investments to be conservative and balanced.

(6) Mr. Bellantoni failed to manage the Sprouses' investments in accordance with their expressed need and desire to have conservative investments.

(7) Mr. Bellantoni's fiduciary duty included a continuing duty to monitor and manage the Sprouses' accounts.

(8) The Sprouses' investment profile underwent a change of circumstances when Dr. Sprouse's mental and physical condition worsened, which should have prompted Allstate and Mr. Bellantoni to review and adjust the Sprouse's investments to a more conservative investment stance.

(9) Allstate and Mr. Bellantoni failed to review and adjust the Sprouse's investments to a more conservative investment stance when the circumstances required it.

(10) As a result of the foregoing, the Sprouses suffered losses, including well managed portfolio damages.

Respectfully submitted this 17th day of March, 2015.

THE DOSS FIRM, LLC

/s/ Jason R. Doss  
Jason R. Doss  
Samuel T. Brannan  
Attorneys for Claimants

36 Trammell Street, Suite 101  
Marietta, Georgia 30064  
Telephone 770.578.1314  
Facsimile 770.578.1302

**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the above and foregoing has been served upon the following by **Email**:

Samantha Tesser Haimo, Esq.  
[tesser@kolawyers.com](mailto:tesser@kolawyers.com)  
Kopelowitz Ostrow P.A.  
Fort Lauderdale, Florida 33301

and

Autumn Crowell, Esq.  
[autumn.crowell@lpl.com](mailto:autumn.crowell@lpl.com)  
LPL Financial LLC  
75 State Street, 24<sup>th</sup> Floor  
Boston, Massachusetts 02109

This 17th day of March, 2015

/s/ Samuel T. Brannan  
Samuel T. Brannan

## **Exhibit 2**

Until Zaha Hadid reinvented architecture, she would not rest. Nor would Patrik Schumacher, her business partner. (London, 1993.)



Until my client *knows* she comes first.

Until I understand what drives her.

And what slows her down.

Until I know what makes her leap out of bed in  
the morning.

And what keeps her awake at night.

Until she understands that I'm always thinking  
about her investments.

(Even if she isn't.)

Not just at the office.

But at the opera.

At a barbecue.

In a traffic jam...

Until her ambitions feel like my ambitions.

Until then...

We will not rest



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## **Exhibit 3**

**FINRA DISPUTE RESOLUTION, INC.**

-----X  
In the Matter of the Arbitration Between:

**[REDACTED]**

FINRA Case No. **[REDACTED]**

**Claimant,**

**-against-**

**ANSWER TO THE  
STATEMENT OF CLAIM**

**UBS FINANCIAL SERVICES INC.,**

**Respondent.**  
-----X

Pursuant to Section 12303 of the FINRA Code of Arbitration Procedure, Respondent UBS Financial Services Inc. (“UBS” or “Respondent”) respectfully submits this Answer to the Statement of Claim (the “Claim”) filed by **[REDACTED]** (“Claimant”). Respondent denies all allegations of wrongdoing and all claims for damages alleged in the Claim.<sup>1</sup>

**INTRODUCTION**

This case is nothing more than an misguided attempt by Claimant to hold UBS responsible as the guarantor of his investments. In support of that improper attempt, Claimant now alleges that his portfolio was overly-concentrated in equity investments which were unsuitable. These allegations are without merit. Claimant completely ignores the fact that his accounts overall did not suffer any net out-of-pocket losses and actually generated profits of over \$300,000 over the course of his relationship with UBS. Moreover, as further demonstrated below, there is no evidence of any wrongdoing by UBS or its Financial Advisor Roger White, who properly performed their responsibilities and had Claimant’s best interests at heart.

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<sup>1</sup> The purpose of this Answer is to explain Respondent’s defenses to the allegations in the Claim without necessarily responding on an allegation-by-allegation basis. Accordingly, should any specific allegation in the Claim not be precisely addressed herein, it is denied.

Claimant fails to describe any specific facts which would support his generalized, empty allegations of unsuitability. The few allegations that convey any information distort and mischaracterize the events that actually transpired, or are just plain wrong. The actual course of dealing between Claimant and UBS was dramatically different from what is described in the Claim, and it involved no impropriety at all on the part of UBS. Intent on manufacturing a claim, Claimant simply ignores reality. At their core, Claimant's allegations are a ploy designed to invoke sympathy for an investor who at all times understood and implemented his investment strategy.

Stated plainly, this case does not arise from legitimate claims of wrongdoing, but rather it stems from Claimant's disappointment over the fact that he decided to withdraw more than \$2.1 million from his accounts between February 1995 and November 2013, causing the value of his portfolio to diminish. Claimant ignored Mr. White's advice and his warnings about Claimant's generosity to friends and family which caused him to make excessive withdrawals. Claimant alone is responsible for his lack of fiscal discipline and cannot plausibly blame Respondent for any losses he incurred therefrom. Claimant's attempt to re-build his portfolio by shifting the responsibility for those decisions onto UBS is baseless and improper.

As neither UBS nor Mr. White have engaged in any wrongful conduct, Claimant's claims should be dismissed in their entirety.

### **STATEMENT OF FACTS**

#### **A. Background**

Claimant is a seventy-six (76) year old retired financial professional. For more than thirty (30) years, Claimant worked in the financial services industry. For years (as early as 1982), Claimant worked for PaineWebber, which was acquired by UBS (the very firm he is now

UBS was not negligent in recommending the investments at issue, or in supervising Mr. White. As such, Claimant is wholly unable to show that any duty owed to him was breached during the course of his relationship with UBS. Therefore, because Claimant cannot prove each of the necessary elements of Claimant's negligence claims, those claims must be dismissed.

**C. Claimant's Breach of Fiduciary Duty Claim Fails.**

Claimant cannot establish that Respondent violated a fiduciary duty in connection with Claimant's non-discretionary accounts. Courts have consistently held that, in general, a broker does not owe a fiduciary duty to his customer on a non-discretionary account. Greenwood v. Dittmer, 776 F.2d 785, 788 (8th Cir. 1985); Heritage Capital, 825 F.2d 171, 173 (7th Cir 1987). A broker does not, in the ordinary course of business, owe a fiduciary duty to a purchaser of securities in a non discretionary account. Layden v. Boccio, 686 N.Y.S.2d 763 (App Div. 1998).

Claimant completed and executed the new account applications and approved all the transactions in connection with the accounts. Claimant also received monthly statements that reflected the current value of the account, the securities held therein, as well as Claimant's withdrawals. Claimant never complained about the investments in his accounts. Claimant cannot now shift the responsibility for his own investment decisions and losses to Respondent.

In any event, even assuming, arguendo, that a fiduciary relationship existed, Claimant cannot establish that Respondent breached any duty owed to Claimant since the transactions in the account were authorized by the Claimant who ratified them after their execution. The investment strategy recommended to Claimant was discussed with Claimant both initially and throughout the relationship, and was consistent with his objective, risk tolerance, and income needs. As stated above, the fact that the investments declined with the market does not render those investments inappropriate. Respondent satisfied the duties owed to Claimant in connection

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.

Suitability determinations are based upon the information available to the financial consultant at the time the recommendation is made, in light of factors including the individual's age, dependents, investment experience, investment assets and willingness to assume risk. The law is clear that "a defendant does not become an insurer against an intervening cause unrelated to the acquisition, e.g., a precipitous price decline caused by a market crash." In re Merrill Lynch & Co., Inc. Research Reports Secs. Litig., 2003 WL 21500293, \*7 (S.D.N.Y. June 30, 2003).

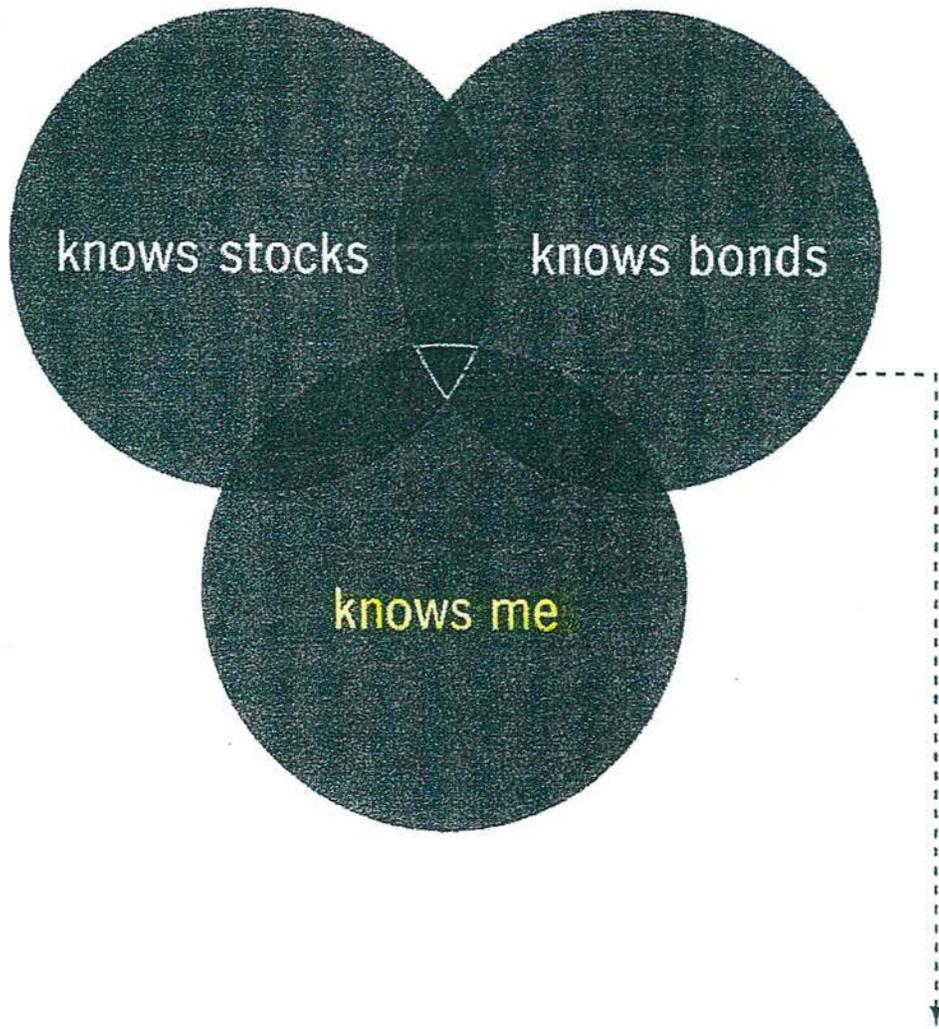
Claimant cannot prevail on his suitability claim. In light of Claimant's financial condition, age, investment objectives, experience, portfolio composition and communications with his Financial Advisor, UBS had "reasonable grounds" for believing that the securities recommendations were suitable at the time they were made.

**B. Claimant's Negligence Claims are Equally Meritless.**

Claimant alleges that Respondent owed the highest duty of care to him in that it entered into a fiduciary relationship with him, and that it breached that duty of care by proximately causing damages to them. Claimant's allegations that UBS acted negligently are entirely without merit. In order to establish a prima facie case of negligence against a broker-dealer, a plaintiff must show: (1) a duty to the plaintiff; (2) a breach of that duty; (3) a reasonably close causal connection between the conduct and the resulting injury; and (4) actual loss, harm or damage. Cromer Finance LTD v. Berger, 137 F. Supp. 2d 452 (S.D.N.Y. 2001).

Claimant cannot show that Respondent breached its duties in making recommendations to him. Respondent's duty to act consistently with the customs and practices of the securities industry is not tantamount to an investment insurance policy. As will be shown at the hearing

## **Exhibit 4**



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## **Exhibit 5**

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 4 Morgan Stanley Smith Barney  
 5 101 California Street, 2nd Floor  
 6 San Francisco, CA 94111  
 7 Ph: (415) 693-6213  
 8 Fax: (415) 693-6250

9 Attorneys for Respondent  
 10 Morgan Stanley & Co., Incorporated

11 **BEFORE FINRA DISPUTE RESOLUTION, INC.**

12 **In the Matter of the Arbitration**  
 13 **between**

14 [REDACTED], and [REDACTED]  
 15 individually and on behalf of their individual  
 16 retirement accounts,

17 **Claimants,**

18 **v.**

19 **CITIGROUP GLOBAL MARKETS, INC. in its**  
 20 **own name and doing business as SMITH BARNEY,**  
 21 **INC., and MORGAN STANLEY & CO.**  
 22 **INCORPORATED,**

23 **Respondents.**

24 **FINRA CASE NO. [REDACTED]**

25 **RESPONDENT MORGAN**  
 26 **STANLEY & CO.**  
**INCORPORATED'S ANSWER**  
**TO STATEMENT OF CLAIM**

27 **I INTRODUCTION**

28 This Answer is submitted on behalf of Respondent Morgan Stanley & Co. Incorporated  
 29 ("Morgan Stanley")<sup>1</sup> in response to the Claimants' Statement of Claim ("Claim").

30 <sup>1</sup> On June 1, 2009, Morgan Stanley and Citigroup Global Markets, Inc. ("Citigroup"), contributed the Global Wealth  
 31 Management Group of Morgan Stanley and the Smith Barney division of Citigroup, respectively, into Morgan  
 32 Stanley Smith Barney Holdings LLC ("Morgan Stanley Smith Barney"), a new joint venture. During the period at  
 33 issue, the Claimants' accounts were not held or serviced by Morgan Stanley Smith Barney. In accordance with the  
 34 agreement between Citigroup and Morgan Stanley, each company retains responsibility for the acts of its employees  
 35 before June 1, 2009. The undersigned counsel for Morgan Stanley in this matter is a Morgan Stanley Smith Barney  
 36 employee and is acting as attorney of record for Morgan Stanley in this matter.

1 Morgan Stanley denies all allegations of wrongdoing asserted by Claimants Bernard [REDACTED]  
2 [REDACTED] against the Firm. Claimants' claim against Morgan Stanley is a classic case of  
3 greed and an attempt to manufacture wrongdoing where none exists. [REDACTED] is an  
4 intelligent and sophisticated investor who has had investment experience for the last 50 years,  
5 since 1959, both as an investor in the market, and as a former owner of successful businesses and  
6 various rental properties. Claimants have had investment accounts at Morgan Stanley for the last  
7 20 years, since 1989, with multiple Financial Advisors at multiple branches. [REDACTED] [REDACTED] has  
8 been a savvy investor, following the markets, monitoring his accounts, and ultimately making his  
9 own investment decisions. For years, his investment strategy was profitable.

10 Preferred stocks were not a new investment for the Claimants in 2003, rather, they had  
11 purchased them throughout their 20 years at Morgan Stanley. [REDACTED] understood and sought  
12 out preferred stocks for the income. With his own research, [REDACTED] [REDACTED] purchased several of the  
13 investments at issue on an unsolicited basis.<sup>2</sup> Moreover, during the time at issue, Claimants  
14 pursued preferred stocks at multiple investment firms. As discussed in the Claim, Claimants also  
15 purchased preferred stocks in brokerage accounts at Smith Barney, which through all of the time  
16 at issue was a separate investment firm from Morgan Stanley.

17 At the end of 2007, when the last investment at issue at Morgan Stanley was purchased,  
18 the investments at issue were only 3.7% of the Claimants' \$1.618 million account at the Firm.  
19 During the increasingly turbulent financial market in 2008 and 2009, the Claimants' investments  
20 declined in value. It is of course unfortunate that the Claimants, like virtually all investors, have  
21 experienced a decline in their investments. Nevertheless, these declines are not actionable.

22 Moreover, although the Claimants' investments at issue have declined, those investments  
23 have continued to provide income. The Claimants' request for damages of \$39,876 from  
24 Morgan Stanley grossly exaggerates their losses, because they fail to account for approximately  
25

26 <sup>2</sup> Any reference herein to the investments "at issue" is referring to the 8 securities identified on pages 10 and 11 of the Statement of Claim that were held in the Morgan Stanley accounts.

1 **3. Respondent did not Breach a Fiduciary Duty**

2 Claimants' claim for breach of fiduciary duty fails because Claimants cannot establish  
3 that a general fiduciary relationship existed, or that if one did exist, that the duty was breached.

4 There is no general fiduciary duty where, as here, the client maintains a non-  
5 discretionary brokerage account. A non-discretionary account is one in which the customer  
6 rather than the broker determines which purchases and sales to make. Claimants' agreement  
7 with Respondent expressly provided:

8  
9 In establishing an Account, you acknowledge that we will be  
10 acting as your broker in connection with the services provided to  
11 the account. We are not acting as your investment fiduciary or  
12 investment advisor with respect to this Account. This means that  
13 you, and not Morgan Stanley, direct all investments in this  
14 Account (unless we have otherwise expressly agreed in writing)  
15 and you bear the ultimate responsibility for all investment  
16 decisions made in this Account.

14 In such a non-discretionary account, the broker is an agent of the client, and the agency authority  
15 is narrowed by the account agreement. See Pavlovich v. National City Bank, 435 F.3d 560, 567  
16 (6<sup>th</sup> Cir. 2006). "[T]he agency relationship created by a non-discretionary account arises when  
17 the client places an order and terminates when the transaction ordered is completed."  
18 Thompson ex rel Thorp Family Charitable Remainder Unitrust v. Federico, 324 F.Supp.2d 1152,  
19 1167 (D.Or. 2004) (citation omitted). Moreover, Mr. Witkin informed Mr. Waldmann that he  
20 did not want a managed account, but rather that he wanted Morgan Stanley to be a "custodian"  
21 for his assets.

22 A stockbroker has no duty "to monitor a nondiscretionary account, or to give advice to  
23 such a customer on an ongoing basis." De Kwiatkowski v. Bear, Stearns & Co., 306 F.3d 1293,  
24 1302 (2d Cir. 2002). "The broker's duties ordinarily end after each transaction is done, and thus  
25 do not include a duty to offer unsolicited information, advice, or warnings concerning the  
26 customer's investments." Id. A broker's investment recommendations do not establish on

1 ongoing fiduciary duty. See Ciccone v. Hersh, 530 F.Supp.2d 574, 578 (S.D.N.Y. 2008)  
2 (granting financial advisor's motion to dismiss breach of fiduciary claim because non-  
3 discretionary account does not embody ongoing fiduciary duties).

4       Where, as here, the client maintains a non-discretionary brokerage account, a fiduciary  
5 duty only arises when the broker exercises control over the account. See, e.g., SEC v. Pasternak,  
6 2008 WL 2501355, at \*36, Civil Action No. 05-3905 (JAP) (D.N.J. June 24, 2008) (explaining  
7 that the weight of authority holds that a broker is in a fiduciary relationship where the broker, not  
8 the customer, retains discretion); see also Independent Order of Foresters v. Donald, Lufkin &  
9 Jenrette, Inc., 157 F. 3d 933, 940-41 (2d Cir. 1998); Lebocc, S.A. v. Merrill Lynch, Pierce,  
10 Fenner & Smith, Inc., 709 F.2d 605 (9th Cir. 1983); ADM Investor Services, Inv. v. Collins, 2006  
11 WL 224095, at \*6, Docket No. 05 C 1823 (N.D. Ill. Jan. 26, 2006) (Seventh Circuit holds that  
12 only a broker in a non-discretionary account is a fiduciary), aff'd 515 F.3d 753 (7<sup>th</sup> Cir. 2008).  
13 The key to determining control is whether the customer can independently evaluate the broker's  
14 recommendations based upon information available to her and her ability to interpret it.  
15 Follansbee v. Davis, Skaggs & Co., 681 F.2d 673 (9th Cir. 1982). "As long as the customer has  
16 the capacity to exercise the final right to say 'yes' or 'no,' the customer controls the account."  
17 Id. at 677.

18       The cases cited by Claimant are not to the contrary. See Johnston v. CIGNA Corp.,  
19 916 P.2d 643, 648 (Colo. App. 1996) (describing several factors considered in determining  
20 whether a broker-dealer owes a fiduciary duty to a customer, including the degree of practical  
21 control of a customer's account by a broker); see also Moses v. Diocese of Colorado, 863 P.2d  
22 310, 321-22 (Colo. 1993) (examining fiduciary relationship in the context of a clergy-parishioner  
23 relationship, and finding its existence is a question of fact, and that fiduciary liability requires not  
24 only a repose of trust, but also an assumption of the fiduciary duty, and a breach of that duty).

25       Claimants retained discretion and control over their accounts, and Respondent took  
26 direction from them. The final decision to buy, sell, or hold was the Claimants' alone. As such,

## **Exhibit 6**

LAW OFFICES  
CASEY CIKLIN LUBITZ MARTENS & O'CONNELL  
A PARTNERSHIP INCLUDING PROFESSIONAL ASSOCIATIONS

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PATRICK J. CASEY, P.A.  
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PHILLIP D. O'CONNELL, SR. (1907-1987)  
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December 11, 2009

*Via facsimile transmission to: 301-527-4868*

Bonnie R. Simon  
Senior Case Administrator  
FINRA Dispute Resolution  
Boca Center Tower 1 - Suite 200  
5200 Town Center Circle  
Boca Raton, FL 33486

Re:

v. Citigroup Global Markets, Inc.; Morgan Stanley  
Smith Barney; ~~John~~ Batista Bocchino a/k/a John  
Bocchino Batista; Does 1 through XX, Inclusive  
FINRA Dispute Resolution Arbitration Number

Dear Ms. Simon:

This letter will serve as the initial Answer and Affirmative Defenses of Respondents Morgan Stanley Smith Barney, formerly known as Smith Barney, a division and service mark of Citigroup Global Markets, Inc. ("MSSB") and John Batista Bocchino ("Bocchino" or collectively "Respondents"), its financial consultant, in response to the Statement of Claim (the "Claim") filed by Claimant ~~Optimum~~ Financial Ltd. ("Optimum" or "Claimant") against Respondents.

I. GENERAL DENIAL

As required by Section 12303 of the FINRA Code of Arbitration Procedure for Customer Disputes, Respondents herein set forth all currently available defenses and relevant facts that will be relied upon at the hearing. Respondents, however, are in the process of gathering and reviewing all of

December 11, 2009

Page 7

operate to reduce the value of the plaintiff's securities, the plaintiff is precluded from recovery under Rule 10b-5." Id.

As set forth above, the evidence will show that Respondents made no misstatements or omissions of material fact to Claimant, that any *alleged* misstatements or omissions were not made with scienter, that Claimant did not justifiably rely on any alleged misstatement or omission, and that its losses were not proximately caused by any alleged misstatement or omission but were instead caused by an investment strategy created by Claimant's own investment advisor that proved unsuccessful.

#### **Nor Does Claimant Have a Cause of Action Premised Upon Any Misrepresentation or Omission**

Respondents never made any misrepresentations to Claimant about its investments or accounts. Yet, Claimant has included such a cause of action in its Claim. To prevail on the misrepresentation claim, (i.e., fraud), Claimant must show: (1) a false statement or misrepresentation of material fact; (2) Respondents' knowledge at the time the representation was made that such statement was false; (3) that the representation was intended to induce Claimant to act in reliance thereon; (4) Claimant's action in justifiable reliance on the representation; and (5) resulting damage or injury to Claimant in so acting. See Thor Bear, Inc. v. Crocker Mizner Park, Inc., 648 So. 2d 168, 172 (Fla. 4<sup>th</sup> DCA 1994). In general, the "false statement of fact" element must concern a past or existing fact." Id. An action for fraud may not be premised upon a promise of future action except where the promise of future action is made with no intention of performing or with a positive intention not to perform. Id.

Negligent misrepresentation is identical, except for the element directed to the respondent's knowledge related to the representation at issue. The claim for negligent misrepresentation requires Claimant to prove: (1) there was a misrepresentation of material fact; (2) the Respondents either knew of the misrepresentation, made the misrepresentation without knowledge of its truth or falsity, or should have known the representation was false; (3) the Respondents intended to induce another to act on the misrepresentation; and (4) injury resulted to the Claimant acting in justifiable reliance upon the misrepresentation. See Florida Womens Medical Clinic, Inc. v. Sultan, 656 So. 2d 931, 933 (Fla. 4<sup>th</sup> DCA 1995).

As set forth herein, the Respondents made no actionable, material, misrepresentation to Claimant. Any representation was not made with knowledge of the falsity, or negligence with regard to its truth or falsity, Claimant could not have acted in justifiable reliance thereon, and suffered no resulting damages from so acting. Accordingly, Claimant's claims for intentional and negligent misrepresentation are without merit and must be dismissed.

#### **Respondents Have Not Breach Any Fiduciary Duties**

Claimant's claim of breach of fiduciary duty fails as a matter of law and should be dismissed in its entirety. Claimant's Claim seeks to impose "fiduciary" obligations and duties on Respondents that only arise in very limited circumstances that do not exist here, i.e. where Respondents are given discretionary trading authority over Claimant's accounts.

To recover on a breach of fiduciary duty claim the Claimant must prove the following: first, that a fiduciary relationship existed, second, that Respondent breached that fiduciary duty, third, that the breach was the proximate cause of, fourth, damages to the plaintiff. Gracey v. Eaker, 837 So. 2d 348, 353, 353 n.1 (Fla. 2002). As a matter of law, Claimants cannot get past the first element of a breach of fiduciary duty claim since there was no fiduciary relationship between Claimant and Respondents. The fiduciary relationship that existed was between Posada and Claimant.

In this non-discretionary account, Respondents only had a duty to do the following: recommend a stock only after studying it sufficiently to become informed as to its nature, price and financial prognosis; carry out the customer's orders promptly in a manner best suited to serve the customer's interest; inform the customer of the risks involved; refrain from self-dealing; not to misrepresent any fact material to the transaction; and, transact business only after receiving prior authorization from the customer. Leib v. Merrill Lynch, Pierce, Fenner & Smith, 461 F. Supp. 951 (E.D. Mich. 1978); see also De Kwiatkowski v. Bear, Stearns & Co., Inc., 306 F.3d 1293 (2<sup>nd</sup> Cir. 2002). Respondents never made any recommendations to Claimant. Respondents followed the instructions received from Claimant's authorized representative, Posada. As such, the only conclusion that can be reached is that Respondents complied with each of these duties and responsibilities with the utmost good faith.

#### **Respondents Have Not Breached Any Contract with Claimant**

In its Claim, Claimant purports to allege several legal causes of action, including breach of contract between Claimant and Respondents. Claimant's claim based on this causes of action lacks merit. In an action for breach of contract, the burden of proof is on the Claimant to prove by a preponderance of the evidence: (1) the existence of a valid contract; (2) a material breach of one or more of the contract's terms; and (3) damages flowing from the breach. See Abbott Laboratories, Inc. v. General Electric Capital, 765 So. 2d 737, 740 (Fla. 5<sup>th</sup> DCA 2000); Carpenter Contractors of America, Inc. v. Fastener Corp. of America, Inc., 611 So. 2d 564, 565 (Fla. 4<sup>th</sup> DCA 1992). Claimant has failed to identify any contract or warranty upon which it seeks relief. It has failed to identify any contract term or warranty that was allegedly breached. In an abundance of caution, Respondents deny that they breached any existent contract term or warranty and deny that Claimant suffered any damages flowing from any alleged breach.

#### **There Can Be No Claim for Negligent Supervision Since Respondents Were Not Responsible for Supervising Posada**

Claimant also asserts a cause of action against MSSB for failure to supervise. MSSB utilizes a multi-faceted supervisory and compliance program. The program includes: (1) review and approval by the Branch Office Manager, or a delegate of all new account applications, (2) daily review by the Branch Office Manager, or a delegate, of each stockbrokers' trades, and (3) monthly review by the Branch Office Manager, or a delegate, of the activity in selected customer accounts. Furthermore, MSSB's compliance department continually reviews customer accounts to detect excessive trading and/or other significant activity. MSSB fully complied with all rules and industry practice in its handling of Claimant's accounts. As such, this claim should also be dismissed in its entirety.

## **Exhibit 7**

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11 Attorneys for Respondents  
12 BERTHEL FISHER & COMPANY FINANCIAL SERVICES, INC., JOHN NOTMAN and  
13 NOTMAN INVESTMENT GROUP, LLC

14 ARBITRATION BEFORE THE  
15 FINANCIAL INDUSTRY REGULATORY AUTHORITY

16 ) FINRA Arbitration No.: [REDACTED]

17 )  
18 )  
19 )  
20 )  
21 )  
22 )  
23 )  
24 )  
25 )  
26 )  
27 )  
28 )

RESPONDENTS' ANSWER TO  
STATEMENT OF CLAIM

Claimants,

v.

JOHN NOTMAN, an individual, NOTMAN  
INVESTMENT GROUP, LLC, a California  
limited liability company, BERTHEL FISHER  
& COMPANY FINANCIAL SERVICES, INC.,  
a foreign corporation, and DOES 1-50,  
inclusive,

Respondents.

Respondent BERTHEL FISHER AND COMPANY ("Berthel Fisher"), JOHN NOTMAN  
("Mr. Notman"), and NOTMAN INVESTMENT GROUP, LLC ("NIG")(collectively,

1 “Respondents”) hereby respectfully submit their Answer to the Statement of Claim (“SOC”)  
2 filed by Y [REDACTED] E, individually and as trustees of  
3 the [REDACTED]  
4 [REDACTED] C (collectively, “Claimants”).  
5

6  
7 I. INTRODUCTION

8 This time-barred<sup>1</sup> arbitration claim is brought by financially sophisticated investors  
9 with over 30 years of experience in real estate investment. Between July 2006 and December  
10 2007, Claimants sold two rental homes in Stockton, California through real estate transactions  
11 under Internal Revenue Code section 1031 (a “1031” exchange”) also known as a “like kind”  
12 exchange. Claimants, in turn, purchased two tenant-in-common (“TIC”) real estate  
13 investments through Respondents. In December 2007, Claimants sold one of their TIC  
14 interests and reinvested the proceeds into another TIC investment. Their total investments in  
15 the three TIC investments at issue total \$451,368.96.  
16

17  
18 In a 1031 exchange, one property is sold and the net proceeds of the sale are rolled into  
19 a “like kind” property or properties. The investor is permitted to defer paying taxes on the gain  
20 from the sale of the original property until a future date – permanently if the acquired property  
21 passes through the owner’s estate.

22 Claimants have known Mr. Notman since 1999. In July of 2006, Claimants decided to  
23 sell one of their nine rental properties and participate in a 1031 exchange. Claimants invested  
24 \$105,368.96 in USA Peachtree Creek DST (“USA Peachtree”).  
25

26  
27 <sup>1</sup> Although FINRA’s six-year eligibility rule does not apply to this case, because it was ordered to arbitration by  
28 the San Joaquin County Superior Court, Respondents assert that the applicable statutes of limitation bar this case.

1 solely on the information provided in the Offering Materials, and did not rely on the  
2 representations of any other person.

3  
4 33. Respondents object to the allegations contained in Paragraph 33 of Claimants'  
5 SOC as stating legal conclusions. In answer to Paragraph 33, Respondent denies that fiduciary  
6 obligations existed towards Claimants, or were breached. Mr. Notman was, at all relevant  
7 times, an independent contractor, not an employee, of Berthel Fisher.

8  
9 Further, Respondents deny that they owed fiduciary duties to Claimants.  
10 Respondents acted solely as a broker-dealer and registered representative, and did not have  
11 discretionary authority over Claimants' account. (*Caravan Mobile Home Sales, Inc. v. Lehman*  
12 *Bros. Kuhn Loeb, Inc.* 769 F.2d 561, 567 (9<sup>th</sup> Cir. 1985), citing *Robinson Merrill Lynch,*  
13 *Pierce, Fenner & Smith, Inc.* 337 F.Supp. 107, 111 (N.D. Ala. 1971), aff'd, 453 F.2d 417 (5<sup>th</sup>  
14 Cir. 1972)). Claimants certified that they relied solely on the disclosures supplied to them in  
15 the Offering Materials and on their own investigation, and did not rely on any representations  
16 from other persons, including Respondents, in choosing to purchase the TIC interests.

17  
18 34. Respondents object to the allegations contained in Paragraph 34 of Claimants'  
19 SOC as vague and ambiguous as to the terms "substantial" and "additional marketing." In  
20 answer to Paragraph 34, Respondents admit that they received commissions of up to 7%, as  
21 well as due diligence fees of up to 1%. The commissions and fees paid to Respondents were  
22 disclosed by the investments' sponsors in the Offering Materials.

23  
24 35. In answer to Paragraph 35 of Claimants' SOC, Respondents deny each allegation  
25 stated in this paragraph. Respondents deny that they committed any wrongdoing with respect  
26 to Claimants' account.  
27  
28

1           **RESPONDENTS DID NOT MAKE ANY INTENTIONAL MISREPRESENTATIONS**

2  
3           36.     In answer to Paragraph 36 of Claimants' SOC, Respondents refer to, and  
4 incorporate by reference, as though fully set forth herein, Paragraphs 1 through 35.

5  
6           37.     In answer to Paragraph 37 of Claimants' SOC, Respondents admit the allegation  
7 that Mr. Notman was, at the times the subject investments were made, a registered  
8 representative associated with Berthel Fisher. In further answer to Paragraph 37, Respondents  
9 admit that Claimants invested in the Tyler Plaza TIC, but deny that they represented the  
10 investment to Claimants as having "zero risk."

11                     The Offering Materials disclosed the material risks associated with the Tyler Plaza  
12 investment. Prior to investing in the Tyler Plaza TIC, Claimants certified that they had read  
13 the Offering Materials and understood the risks associated with the investment, including the  
14 total loss of their investment. Further, Claimants certified many times that they had relied  
15 solely on the information provided in the Offering Materials in deciding to purchase the Tyler  
16 Plaza TIC interest, and did not rely on the representations of any other person.

17  
18  
19           38.     In answer to Paragraph 38 of Claimants' SOC, Respondents admit to the allegation  
20 that Mr. Notman was, at the time the subject investments were made, a registered  
21 representative associated with Berthel Fisher. In further answer to Paragraph 38, Respondents  
22 admit that Claimants invested in the Moody TIC investment, but deny that they represented the  
23 investment to Claimants as a "very good and safe investment which did not have any risk, and  
24 that the Moody TIC would provide a safe and secure income stream."

25  
26                     The Offering Materials disclosed the material risks associated with the Moody  
27 investment. Prior to investing in the Moody investment, Claimants certified that they had read  
28

## **Exhibit 8**

FINRA DISPUTE RESOLUTION

\*\*\*\*\*

Claimants,

FINRA-DR NO. [REDACTED]

- versus -

AMERIPRISE FINANCIAL SERVICES, INC.  
F/K/A H&R BLOCK FINANCIAL ADVISORS,

Respondent.

\*\*\*\*\*

**ANSWER OF RESPONDENT, AMERIPRISE FINANCIAL SERVICES, INC.  
F/K/A H&R BLOCK FINANCIAL ADVISORS**

Ameriprise Financial Services, Inc. f/k/a H & R Block Financial Advisors ("H & R Block") submits this answer to the Statement of Claim filed by individually, and on behalf of the ("Trust") and , individually and on behalf of the Revocable Trust ("Trust") (collectively the "Claimants").

Claimants seek to hold H & R Block liable in an amount exceeding \$250,000 as compensation for a decline in the value of securities they maintained in their H&R Block accounts.<sup>1</sup> Specifically, Claimants allege that H & R Block's recommendations that Claimants invest in reverse convertible notes ("RCNs") and various mutual funds were unsuitable given Claimants' investment objectives and risk tolerance. In making these

<sup>1</sup> Claimants have not yet specified the compensatory damages they are seeking, apart to note that they are requesting in excess of \$250,000. Claimants also seek pre-judgment interest, costs, attorneys fees, and punitive damages.

10.

Respondent owed no fiduciary duties to Claimants and, even if it did, no such duties were breached.

11.

To the extent Claimants seeks to assert claims for alleged violations of NASD, FINRA, or NYSE rules, no such private right of action exists to pursue such claims.

12.

Claimants' claims are barred, in whole or in part, by the equitable doctrines of laches, due diligence, unclean hands, and estoppel.

13.

Claimants' claims are barred, in whole or in part, by their own fault and by the applicable rules of comparative fault.

14.

Claimants are not entitled to recover attorneys' fees under applicable law.

15.

Claimants' claims are barred, in significant part, by applicable statutes of limitations.

16.

Some or all of Claimants' claims, including derivative claims, are not arbitrable under the FINRA rules or any arbitration agreement.

17.

Claimants are not entitled to punitive damages under applicable laws as they fail to state a cause of action that would allow the Panel to grant this type of award.

## **Exhibit 9**

FINANCIAL INDUSTRY REGULATORY AUTHORITY  
DISPUTE RESOLUTION

-----X  
In the Matter of the Arbitration of  
Claimants,  
-against-  
MERRILL LYNCH, PIERCE, FENNER &  
SMITH, INCORPORATED  
Respondents.  
-----X

FINRA-DR Arbitration  
Case No.  
STATEMENT OF ANSWER

Respondents Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") and (collectively, "Respondents"), by their attorneys, Krebsbach & Snyder, P.C., hereby submit their Answer to Claimants' Statement of Claim. Respondents deny Claimants' substantive allegations and deny that they are liable to Claimants for any damages. All factual allegations not specifically admitted herein are denied.

PRELIMINARY STATEMENT

From the opening paragraphs of their Statement of Claim, Claimants' allegations are stunningly at odds with the facts and the truth. In crafting a fable of unsuitability, breach of fiduciary duty and fraud, they accuse their Merrill Lynch financial advisor, Steven Flagg, of placing them in high quality, investment grade, fixed income vehicles that they now claim were incompatible with their purported objective of "safety," based solely on performance in the tumultuous down market that began in the latter part of 2008 as a result of the credit and

also have no legal authority to prosecute a claim for violation of industry rules regarding suitability. In other words, the existence of SRO rules and internal policies of a brokerage firm does not create a duty running from the brokerage firm to the customer, and any purported violation does not provide a private right of action. Thus, any purported claim for violation of industry rules must be dismissed for failure to state a valid cause of action.

**THERE WAS NO NEGLIGENCE OR BREACH OF FIDUCIARY DUTY**

Claimants' CMA was an unmanaged, self-directed account. Mr. Flagg had no discretion to initiate transactions in the CMA, whether purchases or sales. All securities transactions had to be and were reviewed and approved by Claimants in advance.

Claimants have no claim against Respondents premised upon an alleged breach of fiduciary duty or any other duty of care. See, e.g., *Kwiatkowski v. Bear, Stearns & Co., Inc.*, 306 F.3d 1293 (2d Cir. 2002). In *Kwiatkowski*, Bear Stearns had been sued by its client, Kwiatkowski, for millions of dollars in losses in a non-discretionary securities brokerage account, alleging common law negligence and breach of fiduciary duty for failing to warn him of risks, failing to keep him informed of market forecasts and for negligent advice concerning the timing of his trades. The Second Circuit ruled that in a non-discretionary securities account, there is no ongoing duty of reasonable care that requires a brokerage firm to give advice or monitor information beyond the limited transaction-by-transaction duties that are implicated in executing its customer's instructions. *Id.*, 306 F.3d at 1305-07.

*Kwiatkowski* reaffirms the long-standing weight of authority that the duties of a broker in handling a non-discretionary account are limited, and do not rise to the level of a general fiduciary duty or ongoing duty of care. See *Independent Order of Foresters v. Donaldson, Lufkin & Jenrette, Inc.*, 157 F.3d 933, 940 (2d Cir. 1998) (finding that broker-customer

relationship creates no general fiduciary duty); *Salzmann v. Prudential Securities Inc.*, No. 91 Civ. 4253, 1994 U.S. Dist. LEXIS 6377, at \*21-22 (S.D.N.Y. 1994) (broker owes no fiduciary duty to client in a non-discretionary "typical" broker-client relationship); accord *Fekety v. Gruntal & Co.*, 191 A.D.2d 370, 595 N.Y.S.2d 190 (1st Dep't 1993); *Finkel v. Shearson Lehman Hutton Inc.*, N.Y.L.J. Dec. 20, 1994 at p.27 (Sup. Ct. N.Y. Co. 1994) (The "[m]ere unilateral reposal of trust and confidence in reliance upon the expertise of another . . . is insufficient as a matter of law to create a fiduciary relationship"). At the end of the day, Mr. responsibility was to make suitable recommendations, but Claimants made all of the investment decisions and were charged with the responsibility to inform Mr. of any disputes or concerns.

Respondents did not stand in a fiduciary relationship with Claimants. Claimants have not alleged and cannot prove any facts to support a claim that Respondents breached any duty of care to them whatsoever. Accordingly, Claimants' claims for breach of fiduciary duty and for negligence must be dismissed.

**CLAIMANTS' PURPORTED CLAIM FOR FAILURE  
TO SUPERVISE FAILS AS A MATTER OF LAW**

Claimants' purported claim for failure to supervise fails to state a valid claim for relief. *Simply stated, there is no common law claim for failure to supervise.* The obligation to supervise is a regulatory requirement, not a common law duty. Under applicable regulations, broker-dealers are charged with the responsibility of having reasonable supervisory systems in place that are reasonably implemented. Although Merrill Lynch reasonably monitored Claimants' accounts and acted properly in accordance with applicable rules, there is no factual issue regarding supervision that needs to be addressed in this case because, as discussed below, there is no private right of action for a purported failure to supervise.

## **Exhibit 10**

1 MENNEMEIER, GLASSMAN & STROUD LLP  
KENNETH C. MENNEMEIER (SBN 113973)  
2 980 9th Street, Suite 1700  
Sacramento, CA 95814  
3 Telephone: (916) 553-4000  
Facsimile: (916) 553-4011  
4

5 Attorneys for Respondent  
Fidelity Brokerage Services LLC  
6  
7

8 FINRA DISPUTE RESOLUTION, INC.

9 [REDACTED] IER )  
10 [REDACTED] ES, )  
11 [REDACTED] )

12 Claimants,

13 v.

14 MORGAN STANLEY SMITH BARNEY, )  
15 LLC, CROWELL, WEEDON & CO., )  
16 CHARLES SCHWAB & CO., INC., )  
17 FIDELITY INVESTMENTS, INC., MAM )  
18 WEALTH MANAGEMENT, LLC, )  
19 RAFAEL R. SANCHEZ and ALEXANDER )  
20 M. MARTINEZ, )

21 Respondents.  
22  
23  
24  
25  
26  
27  
28

CASE NO: [REDACTED]

**RESPONDENT FIDELITY BROKERAGE  
SERVICES LLC'S ANSWER TO  
STATEMENT OF CLAIM**

1 Respondent Fidelity Brokerage Services LLC ("Fidelity") (erroneously named as  
2 "Fidelity Investments, Inc.") submits this Answer to the Statement of Claim filed by Claimants  
3 [REDACTED]  
4 (collectively, "Claimants"). Fidelity denies any liability to Claimants for any alleged injury.  
5 Fidelity further denies each and every allegation set forth in the Statement of Claim relating to  
6 Fidelity, except as expressly admitted herein.

### 7 I. INTRODUCTION

8 In 2008, Claimants established brokerage accounts with Fidelity, naming  
9 Respondent MAM Wealth Management, LLC ("MAM") as their investment advisor. At that  
10 time, Claimants had been doing business with MAM's employees Respondents Rafael Sanchez  
11 ("Sanchez") and Alexander Martinez ("Martinez") since the mid-1990s, following them from  
12 firm to firm. Before they opened accounts with Fidelity, three of the Claimants had already made  
13 sizeable investments in a real estate limited partnership by the name of MAM Wealth Real Estate  
14 Fund I LP ("MAM Real Estate LP") upon Sanchez's and Martinez's recommendation. As of the  
15 time they opened their Fidelity accounts, Claimants had no prior dealings with Fidelity.

16 In opening Fidelity accounts, Claimants designated MAM as their investment  
17 advisor and gave MAM full authority to trade in their accounts. They signed agreements  
18 acknowledging that MAM was not Fidelity's agent or otherwise affiliated with Fidelity, and  
19 specifically setting forth the respective duties of MAM and Fidelity as to their accounts. They  
20 agreed that Fidelity would only provide custodial, execution, and related ministerial services.  
21 And they agreed that Fidelity would "act only on authorized instructions and has no  
22 responsibility to monitor or review your account, to determine the suitability of any investment,  
23 or to judge the appropriateness of any instruction placed on the account as long as it appears to be  
24 authorized." They also agreed to hold Fidelity harmless in connection with any losses they might  
25 incur due to "any act or omission" of MAM with respect to their accounts.

26 During the period they had Fidelity accounts, Claimants also signed alternative  
27 investment agreements with Fidelity. In those agreements, Claimants acknowledged they and  
28 MAM would have "sole responsibility for the investment, review and management" of any

1 illegal sales of securities by MAM and [MAM Real Estate L.P.] to Claimants in violation of  
2 California and federal securities laws, and in violation of applicable FINRA rules.” *Id.* at 24-25.

3           These claims are baseless under the governing law. Furthermore, even assuming  
4 that Claimants could otherwise state a cause of action against Fidelity, they have released Fidelity  
5 from liability for all claims. Finally, even if Fidelity is held liable for any losses incurred by  
6 Claimants, MAM must indemnify Fidelity for any such liability.

7           **A. Fidelity Did Not Owe Claimants Any Fiduciary Duty**

8           Claimants first claim fails because Fidelity did not owe them any fiduciary duty.

9 Claimants acknowledged as much when they signed account applications and alternative  
10 investment agreements disclosing Fidelity’s limited role and responsibilities. As a matter of law,  
11 those agreements defeat any breach of fiduciary claim.

12           Courts have consistently refused to hold brokerage firms liable for merely  
13 executing trades made by independent investment advisors vested with sole discretionary  
14 authority over an account. The case of *Mars v. Wedbush Morgan Securities, Inc.*, 231 Cal. App.  
15 3d 1608, 1614 (1991), is particularly on point. In that case, the plaintiff investor sued both his  
16 investment advisor and the brokerage firm that maintained plaintiff’s brokerage account. Like  
17 Claimants here, the investor had signed an agreement with the broker, agreeing that the broker  
18 would execute trades in the investor’s account on the investment advisor’s instructions, the  
19 broker would not provide advice regarding investments, and the investment advisor would be  
20 responsible for all activities in the investor’s account. Under these circumstances, the court held  
21 that the firm owed no fiduciary duty to the investor. *Id.* at 1614. The court explained that the  
22 broker had no direct contact with plaintiff, “it did not recommend transactions, give advice, or  
23 determine suitability of the trading.” *Id.* at 1614-1615.

24           The Massachusetts Supreme Court reached a similar result in *Vogelaar v. H.L.*  
25 *Robbins & Co.*, 348 Mass. 787 (1965), a case involving far greater contact between the investor  
26 and the brokerage firm. There the plaintiff investor alleged that he had transferred funds to his  
27 stockbroker for investment, and accused the firm of self-dealing and churning his account. The  
28 court granted the broker’s demurrer and dismissed the investors’s claims, holding that his



## **Exhibit 11**

1 OFFICE OF GENERAL COUNSEL  
2 WELLS FARGO BANK, NATIONAL ASSOCIATION  
3 VANESSA M. HOFFMANN, SBN 206086  
4 45 FREMONT ST. FL 26, MAC A0194-266  
5 SAN FRANCISCO, CA 94105  
6 TEL (415) 396-4386 FAX (415) 975-7864

7 Attorney for Respondent  
8 WELLS FARGO ADVISORS, LLC

9 FINRA DISPUTE RESOLUTION  
10 NORTHEAST REGIONAL OFFICE

11 [REDACTED]

12 Case No.: [REDACTED]

13 Claimant,

14 RESPONDENT WELLS FARGO  
15 ADVISORS LLC'S ANSWER TO  
16 STATEMENT OF CLAIM

17 vs.

18 MORGAN STANLEY SMITH BARNEY,  
19 LLC AND WELLS FARGO ADVISORS,  
20 LLC.

21 Respondents.

22 I. INTRODUCTION

23 Claimant [REDACTED] alleges Wells Fargo Advisors, LLC ("WFA") is liable for roughly  
24 \$300,000 in losses that stem from an "unsuitable and speculative" investment strategy of which  
25 she was supposedly unaware and a solicitation to invest away from WFA. However, [REDACTED]  
26 claims against WFA are belied by her own allegations and the undisputed facts in this matter.

27 [REDACTED] a 46 year old sophisticated real estate entrepreneur, made written  
28 representations to WFA that she sought a "trading and speculation" objective for her brokerage  
account and that she had the financial net worth (in excess of \$10MM) and the experience to

1 sustain that high level of risk. Furthermore, [REDACTED] maintained the same speculative trading  
2 strategy for numerous years prior to transferring her account to WFA and never raised any issue.  
3 In fact, [REDACTED] notes in her Statement of Claim that she was approached twice while at Morgan  
4 Stanley and again at WFA by management to discuss the very trading activity, risk, and  
5 commissions in her brokerage accounts about which she now complains. Not only did [REDACTED]  
6 admittedly fail to raise any concerns, she chose instead to continue the same investment strategy.  
7 Finally, [REDACTED] allegation that WFA is somehow liable for Mr. Hsieh's supposed solicitation  
8 to invest in a restaurant/bar is nothing more than a red herring. By her own admission, WFA was  
9 not advised of or otherwise connected to this alleged restaurant/bar. Accordingly, WFA has no  
10 liability for any alleged business venture which, if done, was clearly outside the scope of Mr.  
11 Hsieh's employment with WFA.  
12  
13

## 14 II. FACTUAL BACKGROUND

### 15 A. [REDACTED] Was A Long Standing Client And Friend Of Mr. Hsieh Well Before He 16 Joined WFA.

17  
18 As noted in the Statement of Claim, Mr. Hsieh knew [REDACTED] [REDACTED] for many years before he  
19 joined WFA in late 2009. Mr. Hsieh and [REDACTED] met while [REDACTED] was a student at New York  
20 University in the 1990s. After graduating from the Stern School of Business at NYU, [REDACTED]  
21 joined Citigroup and worked as a currency derivatives trader. She and Mr. Hsieh remained  
22 friends and spoke frequently. Given her background with currency derivatives, [REDACTED] had a  
23 sophisticated understanding of the market and acumen for securities. The stock market was  
24 almost always a topic of conversation.  
25  
26  
27  
28

1 employee's actions are not authorized by his employer and he is acting for his own interests and  
2 not in furtherance of her employer's business, the employer cannot be held vicariously liable for  
3 the employee's actions.

4  
5 WFA cannot be held vicariously liable for the alleged conduct of Mr. Hsieh because he  
6 was not acting within the scope of his employment. An employee is acting within the scope of  
7 employment when the employee "is doing something in furtherance of the duties he owes to his  
8 employer" or otherwise has an intent to further the employer's business. *Hamm v. U.S.*, 483 F.3d  
9 135, 138 (2d Cir. 2007). The conduct alleged by ██████ was not in furtherance of WFA's  
10 business and, therefore, WFA cannot be held liable for it.

11  
12 D. Breach of Fiduciary Duty

13 ██████'s account with WFA was nondiscretionary, which means that it was ██████  
14 who made all of the decisions regarding the trades made within the account. The law establishes  
15 that a broker does not owe a fiduciary to a customer with respect to a non-discretionary account.

16  
17 "A nondiscretionary customer by definition keeps control over the account and has full  
18 responsibility for trading decisions." *DeKwiatkoski v. Bear Stearns & Co., Inc.*, 306 F.3d 1293,  
19 1302 (2002) (citations omitted.) Accordingly, there is no fiduciary duty owed to ██████.

20  
21 Moreover, as discussed above, ██████ was not a conservative investor as she now  
22 alleges. Her portfolio was traded in a manner consistent with her stated objectives and risk  
23 tolerance, which was "trading and speculation." It was also in accordance with her years of  
24 investment experience and financial situation. Furthermore, ██████ was not prevented from  
25 accessing and/or controlling her account activity. From the outset, ██████ was provided  
26 sufficient information to establish her account profile and she consistently represented her desire  
27  
28

1 to speculatively trade her account. Accordingly, [REDACTED] blame of WFA for any of her losses  
2 is misplaced.

3 E. Claims For Violations FINRA Rules And State and Federal Securities Laws

4 For all the reasons stated above, [REDACTED] other claims concerning violations of FINRA  
5 rules and state and federal securities law necessarily fail. WFA acted in accordance with all  
6 applicable laws and regulations. The evidence described above and to be introduced will  
7 establish that [REDACTED] authorized and ratified the trading activity in her account. There were no  
8 misrepresentations or material omissions made with scienter. [REDACTED] is an experienced,  
9 aggressive, and opinionated investor. WFA provided her all the necessary disclosures and  
10 information related to her investments. In addition, [REDACTED] provided WFA written and oral  
11 representations that she sought to speculatively trade her account and acknowledged the risks  
12 and costs related to that strategy.

13  
14  
15 **IV. AFFIRMATIVE DEFENSES**

16  
17 In addition to the facts summarized above, WFA believes that the following affirmative  
18 defenses may preclude claimant from recovering damages in this case.

- 19 1. The Statement of Claim fails to state a claim upon which relief can be granted.  
20  
21 2. By reason of her representations made to respondent and authorization of the  
22 investments at issue, Claimant's claims are barred by the equitable doctrines of  
23 waiver, estoppel and/or laches.  
24  
25 3. By not objecting to the transactions at issue or notifying respondent that her  
26 instructions were not carried out, claimant ratified and approved the alleged wrongful  
27 conduct.  
28

## **Exhibit 12**

1 GEOFFREY S. BECKHAM  
California Bar No. 224126  
2 CHARLES SCHWAB & CO., INC.  
Office of Corporate Counsel  
3 211 Main Street  
San Francisco, California 94105  
4 Telephone: (415) 667-0154  
Facsimile: (415) 667-1638

5 Attorney for Respondent  
6 Charles Schwab & Co., Inc.

7  
8  
9 **BEFORE THE**  
10 **FINANCIAL INDUSTRY REGULATORY AUTHORITY**

11 In The Matter of the Arbitration Between

12 [REDACTED]

13 Claimant,

14 v.

15 Charles Schwab & Co., Inc.,

16 Respondent.  
17  
18

FINRA Dispute Resolution Case Number:  
19 [REDACTED]

20 **STATEMENT OF ANSWER OF**  
21 **RESPONDENT CHARLES SCHWAB &**  
22 **CO., INC.**

23 Pursuant to Rule 12303 of the Financial Industry Regulatory Authority ("FINRA") Code of  
24 Arbitration Procedure for Customer Disputes, Respondent Charles Schwab & Co., Inc., ("Schwab")  
25 hereby submits this Statement of Answer to the Statement of Claim filed by [REDACTED],  
26 Individually, on behalf of his IRA.

27 **GENERAL DENIAL**

28 Schwab denies each and every substantive allegation contained in the Statement of Claim,  
unless expressly admitted herein, and denies that [REDACTED] has suffered any damages, if at all,  
attributable to Schwab.

1 **LEGAL ARGUMENT**

2 **A. There is no Private Right of Action for Alleged Violations of FINRA Rules.**

3 First and foremost, the evidence will show that Schwab did not violate any FINRA or SEC  
4 rule. Second, even if there was a technical violation, an investor cannot file an arbitration against his  
5 brokerage firm based on an alleged violation of SRO rules. FINRA rule violations do not create a  
6 legal claim for money damages (a “private right of action”) by an investor against his broker. *See*  
7 *Hoxworth v. Blinder, Robinson & Co.*, 903 F.2d 186, 200 (3d Cir. 1990) (“NASD [now FINRA]  
8 regulations do not give rise to a private right of action”); *See also Thompson v. Smith Barney, Harris,*  
9 *Upham & Co.*, 709 F.2d 1413, 1419 (11th Cir. 1983); *Jablon v. Dean Witter & Co.*, 614 F.2d 677,  
10 680-81 (9th Cir. 1980) (There is no private cause of action for violations of NYSE rules).

11 Claimant cannot recover damages (monetary or otherwise) against Schwab based on an  
12 alleged violation of FINRA rules. This cause of action should be dismissed as a matter of law.

13 **B. Schwab Has No Duty to Monitor the Trading Activity in Claimant’s Non-**  
14 **Discretionary Account.**

15   
16   
17  *See, e.g., Press v. Chemical Investment Services Corp.*, 988 F. Supp. 375, 386-87  
18 (S.D.NY 1997) (broker generally owes no fiduciary duty to client); *Fekety v. Gruntal & Co.*, 191  
19 A.D.2d 370, 371, 595 N.Y.S.2d 190, 190-91 (1st Dept. 1993) (same). A broker is not a generalized  
20 fiduciary with respect to an account over which it is not given discretion. *See, e.g., De Kwiatkowski*  
21 *v. Bear, Stearns, & Co., Inc.*, 306 F.3d 1293, 1308 (2d Cir. 2002); *Independent Order of Foresters v.*  
22 *Donaldson, Lufkin & Jennette, Inc.*, 157 F.3d 933, 940 (2d Cir. 1998) (broker-customer relationship  
23 does not give rise to a generalized fiduciary duty).

24 Accordingly, Schwab’s duties with respect to Claimant’s account are clearly set forth in the  
25 account agreement. In Section 31 of the agreement, Claimant agreed and acknowledged that he  
26 would be solely responsible for his investments, and that Schwab would not review or monitor the  
27 trading activity in his account. As relevant here, the agreement provided:

28 **Investment Advice.** You [Claimant] agree and acknowledge that:

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- Unless we otherwise agree with you in writing, Schwab will act only as your broker-dealer and not as an investment advisor; any investment advice you receive from Schwab will be provided solely incidental to Schwab's brokerage services; and your account will be a brokerage account and not an investment advisory account governed by the Investment Advisors Act of 1940;
- You, or you and your investment manager if you have one, are responsible for determining the nature, potential value and suitability for you of any particular investment strategy, transaction (including futures transactions) or security (including equities and options);
- Unless we otherwise agree with you in writing, Schwab does not have any discretionary authority or obligation to review or make recommendations for the investment of securities or cash in your account;
- You, or you and an Investment Advisor other than Schwab, if you have one, will rely on multiple sources of information in making investment decisions for your Account, and any information Schwab may provide will not serve as the sole basis for any investment decision you make or made on your behalf;
- You, or you and an Investment Advisor other than Schwab, if you have one, have an affirmative duty to monitor profits and losses in your Account and to modify your trading decisions accordingly;
- While Schwab may make available its own proprietary research, or other information, this does not constitute an individualized recommendation that a security or transaction is appropriate for you or your Account.

Quite simply, Schwab is not responsible for the self-directed trading activity in Claimant's account, and Schwab has no duty to review or monitor the account (even though Schwab options representatives did check in with Mr. Meadows on several occasions; each time, he elected to stay the course). This was the contractual agreement between the parties, and it was never changed or modified.

**C. Schwab Has No Liability to Claimant For Any Allegedly Unsuitable Investments Made in Claimant's Accounts.**

To the extent Claimant's claims are derived from the allegedly unsuitable investments made in Mr. Meadow's portfolio, such claims must be rejected because (1) Schwab did not recommend or