CASES & MATERIALS

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11th Circuit Defines Materiality in Connection with the Purchase or Sale of a Security

Brink v. Raymond James & Associates, Inc., No. 16-14144 (11th Cir., June 8, 2018)

This appeal addresses the preclusive effect under Title I of the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), which prohibits class actions alleging state law causes of action based on conduct that constitutes federal securities fraud. Appellant Brink disputed that her complaint against Raymond James & Associates ("RJA") alleged a "misrepresentation…of a material fact in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1)(A).

As an alternative to a traditional commission-based investment account, RJA offered a "Passport Account" program that charged customers an annual advisory fee based on the total value of qualifying assets in the account instead of a commission based on each individual trade. Passport Account customers were charged a flat fee per transaction. In its written agreement with each Passport Account customer, RJA described this flat fee as a "Processing Fee" for "transaction execution and clearing services" and stated that the Processing Fees were "not commissions". RJA's actual costs incurred in the execution and clearing of the transactions were much lower than the Processing Fees charged. RJA kept as profit any amount above the actual costs associated with transaction execution and clearing.

Brink filed a putative class action complaint alleging state law claims for breach of contract and negligence. Brink alleged that because Passport Account customers had agreed only to pay for "expenses incurred in facilitating the execution and clearing" of their trades, RJA's undisclosed profit built into the Processing Fees breached the Passport Agreement. Brink also claimed that RJA breached its duty of care owed to its customers, which she alleged included a duty to charge customers a reasonable fee for its services.

RJA filed a motion to dismiss for lack of subject matter jurisdiction, arguing that Brink's state law claims were disguised claims for federal securities fraud, and therefore, were precluded under SLUSA. The question before the appellate court was whether the representation by RJA to its

Passport Account customers that the Processing Fee covered only the actual costs of transaction execution and clearing constitutes a "misrepresentation or omission of a material fact in connection with the purchase or sale" of those securities. The court found that a reasonable investor would not have made a different investment decision had they known that some of the processing fee included a profit for RJA, and therefore, the hidden profit on the processing fee is not material under federal securities law. As a result, the court concluded that SLUSA did not prohibit Brink's putative class action because RJA's alleged failure to disclose the hidden profit built into the Processing Fee is not a misrepresentation of material fact for purposes of SLUSA.

3rd Circuit Rules on Forum Selection Clauses

Reading Health Sys. v. Bear Stearns & Co., 2018 U.S. App. LEXIS 21910,___ F.3d___ 2018 WL 3735206 (3rd Cir. 2018)

In this case the court addresses an emerging trend in the brokerage industry. Ordinarily, broker-dealers, as members of the Financial Industry Regulatory Authority (FINRA), are required by FINRA Rule 12200 to arbitrate all claims brought against them by a customer. Seeking to avoid this obligation to arbitrate, broker-dealers began inserting forum-selection clauses in their customer agreements, without mentioning the customer's right to arbitrate. This practice, which has been condoned by several circuits, deprives investors of the benefits associated with using FINRA's arbitral forum to resolve brokerage-related disputes.

This case concerns such a forum-selection clause. Over the course of several years, Bear Stearns & Co., now known as J.P. Morgan Securities LLC (hereinafter J.P. Morgan), a broker-dealer and FINRA member, executed several broker-dealer agreements with Reading Health System. The agreements were executed in connection with four separate offerings of auction rate securities (ARS), through which Reading issued more than $500 million in debt. Two of those contracts included forum-selection clauses providing that "all actions and proceedings arising out of" the agreements or underlying ARS transactions had to be filed in the District Court for the Southern District of New York.

After the ARS market collapsed, Reading filed a statement of claim with FINRA, alleging that J.P. Morgan engaged in unlawful conduct in connection with the ARS offerings and demanding that those claims be resolved through FINRA arbitration. J.P. Morgan refused to arbitrate, however, contending that

Reading had waived its right to arbitrate by agreeing to the forum-selection clauses. To resolve this standoff, Reading filed a declaratory judgment action to compel FINRA arbitration in the District Court for the Eastern District of Pennsylvania. In response, J.P. Morgan moved to transfer the action to New York, based on the forum-selection clauses in some (but not all) of the broker-dealer agreements.

In this appeal, the court sought to answer two questions: (i) whether J.P. Morgan, as a FINRA member, is obligated to resolve Reading's substantive claims through FINRA arbitration; and (ii) which court decides that question of arbitrability. The court held that the transfer question must be resolved before the question of arbitrability. The court reasoned that Reading's action to compel FINRA arbitration did not "arise out of" the broker-dealer agreements because Reading's sole claim for declaratory relief did not involve an assertion of Reading's contractual "rights or duties." The only right Reading sought to enforce in its complaint is its right to arbitrate its claims against J.P. Morgan. That right does not originate from the broker-dealer agreements, but rather from FINRA Rule 12200, which gives Reading the right to demand FINRA arbitration and imposes a corresponding duty on J.P. Morgan to arbitrate. Because the sole source for Reading's right to arbitrate is FINRA Rule 12200—without which Reading would not be entitled to compel arbitration, and J.P. Morgan would not have a duty to arbitrate—Reading's declaratory judgment action does not "arise out of" the broker-dealer agreements.

Reading's declaratory judgment action to compel arbitration is not one "arising out of" the broker-dealer agreements, therefore it does not fall within the scope of the forum-selection clause. The court found that the district court properly required J.P. Morgan to submit to FINRA arbitration because the forum-selection clause did not waive Reading's right to arbitrate under FINRA rule 12200. Therefore, the court affirmed the District Court's order denying J.P. Morgan's motion to transfer the action to the Southern District of New York. The court further reasoned that attempts to reconcile the tension between a broker-dealer's right to litigate pursuant to a forum-selection clause and a customer's corresponding right to arbitrate under FINRA Rule 12200 have divided our sister circuit courts. The Second and Ninth Circuit Courts of Appeals have held that a materially identical forum-selection clause require the parties to litigate in federal court, while the Fourth Circuit Court of Appeals has held that Rule 12200 requires the parties to arbitrate notwithstanding the presence of a forum-selection clause.

The court determined that it agreed with the Fourth Circuit that the question is one of waiver, and that the forum-selection clauses did not implicitly waive Reading's right to FINRA arbitration. The court held that

Reading's right to arbitrate is not contractual in nature, but rather arises out of a binding, regulatory rule that has been adopted by FINRA and approved by the SEC. The court reasoned that by condoning an implicit waiver of Reading's regulatory right to arbitrate, it would erode investors' ability to use an efficient and cost-effective means of resolving allegations of misconduct in the brokerage industry and thus undermine FINRA's ability to regulate, oversee, and remedy any such misconduct. Therefore, the court held that the District Court properly concluded that, under FINRA Rule 12200, J.P. Morgan is required to arbitrate Reading's claims regarding the ARS offerings.

Summary Judgement Grated Against Ramirez

SEC v. Ramirez, Civil No. 15-2365, 2018 U.S. Dist. LEXIS 74481(D.P.R. April 30, 2018)

Ramírez was a registered representative of UBS Financial Services Inc. of Puerto Rico. The SEC claims that from approximately 2006 through approximately 2013, Ramírez made material omissions and misrepresentations to customers and effected a fraudulent scheme that increased his compensation by soliciting customers to improperly use proceeds from lines of credit offered by a UBS-PR affiliate in order to purchase securities despite the fact that he knew UBS-PR's policy and the line of credit agreements prohibited customers from using loan proceeds to purchase securities.

The SEC filed a Motion for Partial Summary Judgment on the Issue of Liability and Accompanying Memorandum of Law and Ramírez opposed and filed a Motion to Strike. The court found that Ramírez was aware that UBS-PR policy did not allow customers to use LOC proceeds to purchase securities, and that UBS-USA's LOC loan agreement prohibited it. Despite those prohibitions, he presented customers a way to make additional money by using LOCs to increase their CEF holdings. In order to circumvent UBS-PR's policy against using LOCs to purchase securities, Ramírez directed his customers to request wire transfers or write checks from their LOCs to the customers' personal bank accounts in other banks. Afterwards, customers were instructed, to deposit the funds recently deposited in their outside bank accounts, into their UPS-PR brokerage accounts, to allow Ramírez to execute trades for additional CEF shares. The scheme avoided detection because UBS-PR did not have a procedure designed to catch transfers from LOCs to outside banks and from outside banks back to UBS-PR. Ramírez was a top performing registered representative at UBS-PR with regard to LOC business production. He

received recognition as a "Banking Champion". His compensation was based, in part, on his LOC production and the amount of funds his customers withdrew upon their LOCs. He earned commissions on the CEFs his customers purchased, and from 2011-2013, he received over $12.9 million in total compensation, over $5.5 million of which was attributable to customer LOCs.

Ramírez disputes the SEC's statements of fact on Fifth Amendment grounds arguing that: (1) he invoked the Fifth Amendment; (2) no adverse inference may be derived from his invocation of the Fifth Amendment at the summary judgment stage; and (3) the SEC has not produced independent admissible evidence of wrongdoing. The court reasoned that the Fifth Amendment privilege against compelled self-incrimination applies in civil and criminal proceedings, however, the privilege operates differently in criminal and civil contexts. In criminal cases, no negative inference from the accused's silence may be made, but in civil cases adverse inferences are permitted against parties, when they refuse to testify in response to probative evidence offered against them. The court found that by solely relying on the Fifth Amendment, Ramírez failed to create a genuine issue of material fact.

The court further found that Ramirez's misrepresentations and omissions were material. A "misrepresentation is material if there is a substantial likelihood that the misrepresentation would affect the behavior of a reasonable investor." *Ficken,* 546 F.3d at 47 (so recognizing); *S.E.C. v. Fife*, 311 F.3d 1, 10 (1st Cir. 2002)("misrepresentations and omissions were material because a reasonable investor would want to know the risks involved"). The court found that the investors would have wanted to know the risks involved in the recommended strategy, including the risk of loss of principal, and the risk of maintenance calls in the event the value of LOC collateral decreased. The court also found that investors would have been interested in knowing that Ramírez's recommendations were in direct contravention of UBS-PR policy and of the LOC agreements.

The court concluded that the SEC established all the necessary elements to show that Ramírez violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5. As a result, the court granted Plaintiff's Motion for Partial Summary Judgment on the Issue of Liability and Accompanying Memorandum of Law and Ramírez's Motion to Strike was denied.

Importance of Beneficiary Designations

Cooper v. D'Amore, 881 F.3d 247 (1st Cir. 2018)

In 2003, decedent, an investment executive/bond trader at Mesirow Financial Inc., established an IRA through his employer. At the time, decedent was married to D'Amore and designated her as the beneficiary. In 2006, decedent and D'Amore divorced and entered into a Martial Settlement Agreement which provided, in part, that "[e]ach party shall continue to own as his or her own separate property any Individual Retirement Account (IRA), pension or retirement plan in his or her name, and each does hereby waive any claim to such account of the other." Notwithstanding the Martial Settlement Agreement, decedent did not revoke the beneficiary designation for the Mesirow IRA.

On August 18, 2011, decedent completed a TD Ameritrade "Account Transfer Form" in order to transfer his assets from the Mesirow IRA to a TD Ameritrade IRA. On July 21, 2012, decedent died. Thereafter, Mesirow distributed the assets that remained in the Mesirow IRA to D'Amore pursuant to the beneficiary designation. The Cooper's sued D'Amore, seeking to recover the assets distributed by Mesirow to D'Amore. The parties filed cross-motions for summary judgment. The district court granted summary judgment for the Coopers, finding that upon divorce, D'Amore's beneficiary designation was revoked pursuant to the Illinois Trusts and Dissolutions of Marriage Act. On November 20, 2015, D'Amore filed a motion for reconsideration. Thereafter, the court determined that its summary judgment decision was improper because Delaware law, not Illinois law, governed the IRA. The court then imposed sanctions on the Coopers' counsel for the failure to turn over an authenticated copy of the Delaware Charter Trust document, and granted D'Amore's motion for summary judgment. The Coopers appealed and the court vacated the district court's entry of summary judgment on behalf of D'Amore because it found that the Delaware Charter IRA Trust Agreement was not in effect at the time the assets were distributed. On remand, the parties again moved for summary judgment. This time, the district court granted summary judgment for the estate. The court explained that from 2006, when the couple divorced, until August 2011, when the decedent transferred his assets, D'Amore was the beneficiary, but when decedent requested a transfer of all of his assets in 2011, the beneficiary designation was automatically revoked and the account terminated. This appeal followed.

The court reasoned that an IRA is composed of a variety of assets and some of the assets may not be transferable in their current form. The court found that in completing his transfer request, decedent had the opportunity to

transfer all of his assets out of the Mesirow account, but he chose to direct a transfer of only those assets that were transferable. The court found that the decedent is assumed to have known that certain assets in the IRA were transferable, while others were nontransferable in their current form. If decedent wanted to direct a transfer of "all assets," he had to authorize a change of the nontransferable assets so that they could be transferred. Rather than doing that, however, decedent chose to transfer only those assets that were transferable. Thereafter, his agreement with Mesirow continued for the remaining nontransferable assets in the account.

The court reasoned that while the Mesirow IRA statements post-transfer failed to list D'Amore as the beneficiary, the statements simply stated that the beneficiary was "not provided." This does not establish that the beneficiary designation was revoked. Furthermore, the Plaintiffs' basis for their claim is that when the Mesirow IRA terminated, D'Amore's beneficiary designation was revoked. The court found that the account did not terminate, and therefore, the Coopers' argument that the beneficiary designation was revoked by account termination necessarily fails. As a result, the court reversed the summary judgment for the Coopers. A request to transfer all assets was never made; therefore, the beneficiary designation was never revoked and D'Amore was entitled to the remaining assets in the account upon decedent's death. The court therefore remand the case to the district court with directions to enter summary judgment for D'Amore.

Brokers Sue FINRA and Federal Jurisdiction Argument Fails

Webb v. Fin. Indus. Regulatory Auth., 889 F.3d 853 (7th Cir. 2018)

Brokers Nicholas Webb and Thad Beversdorf were fired by their employer, Jefferies & Company, Inc. ("Jefferies"). They decided to challenge their termination, and, as their employment contracts with Jefferies demanded, they filed their claims in the Financial Industry Regulatory Authority's ("FINRA") arbitration forum. FINRA required them to sign an "Arbitration Submission Agreement," which they did, and their dispute with Jefferies proceeded in arbitration for the next two-and-a-half years, however they withdrew their claims before a final decision was rendered. Under FINRA's rules, that withdrawal constituted a dismissal with prejudice.

After the arbitration failed, Webb and Beversdorf sued FINRA in the Circuit Court of Cook County, Illinois, alleging that FINRA breached its contract to arbitrate their dispute with Jefferies. They faulted FINRA for a number of things, including failing to properly train arbitrators, failing to

provide arbitrators with appropriate procedural mechanisms, interfering with the arbitrators' discretion, and failing to permit reasonable discovery. They sought damages "in an amount in excess of $50,000" and a declaratory judgment identifying specified flaws in FINRA's Code of Arbitration Procedure. FINRA removed the dispute to federal court, where it moved to dismiss on multiple grounds, including arbitral immunity. The district court held that FINRA was entitled to arbitral immunity and dismissed the suit. Webb and Beversdorf appealed.

After it removed the case to federal court, FINRA initially claimed that the amount in controversy was satisfied because Webb and Beversdorf sought more than $1,000,000 from Jefferies. The district court properly rejected this argument, because the amount at stake in an underlying arbitration does not count toward the amount in controversy in a suit between a party to the arbitration and the arbitrator. *Caudle v. American Arbitration Ass'n*, 230 F.3d 920, 922-23 (7th Cir. 2000). Jurisdiction turns on what is at stake between the parties to the suit—Webb and Beversdorf, the plaintiffs, and FINRA, the defendant.

Webb and Beversdorf paid FINRA $1,800 at the start of the arbitration; if that is all they lost, the amount in controversy is obviously far short of the jurisdictional mark. They also, however, seek to recover the legal fees that they incurred both in the course of arbitrating against Jefferies and in preparing this lawsuit against FINRA. Webb and Beversdorf say that these fees—which exceed $75,000—were a reasonably foreseeable consequence of FINRA's breach of the Arbitration Submission Agreement. The district court accepted this argument and concluded that it had authority to adjudicate the suit. The court reasoned that legal fees may count toward the amount in controversy if the plaintiff has a right to them "based on contract, statute, or other legal authority." *Ross v. Inter-Ocean Ins. Co.*, 693 F.2d 659, 661 (7th Cir. 1982). Webb and Beversdorf do not contend that FINRA assumed a contractual obligation to cover either the fees that they incurred in arbitration or those that they incurred in this lawsuit. Illinois generally adheres to the American Rule that each party bears its own litigation costs. Therefore, the court reasoned that it is clear that Webb and Beversdorf cannot recover the money spent preparing to litigate against FINRA.

Webb and Beversdorf also seek recovery of the legal fees they incurred arbitrating against Jefferies. The court found that this is a more plausible ground for recovery, because Illinois recognizes a "third party litigation exception" to the American Rule. The Illinois Supreme Court has held that "where the wrongful acts of a defendant involve the plaintiff in litigation with third parties or place him in such relation with others as to make it necessary to incur expense to protect his interest, the plaintiff can then recover damages

against such wrongdoer, measured by the reasonable expenses of such litigation, including attorney fees." *Ritter v. Ritter*, 381 Ill. 549, 46 N.E.2d 41, 44 (Ill. 1943).

Webb and Beversdorf's effort to recover expenses incurred in an arbitration proceeding begun for its own purposes—to assert a wrongful termination claim against Jefferies—distinguishes this case from those in which Illinois courts have applied the exception. When a defendant removes to federal court, as FINRA did here, its plausible and good faith estimate of the amount in controversy establishes jurisdiction unless it is a "legal certainty" that the plaintiffs' claim is for less than the requisite amount. *St. Paul Mercury Indem. Co. v. Red Cab Co.*, 303 U.S. 283, 58 S. Ct. 586, 82 L. Ed. 845, 1938 U.S. LEXIS 295. Here, Illinois law makes it a "legal certainty" that Webb and Beversdorf's claim is for less than the requisite amount. Therefore, jurisdiction does not exist.

FINRA makes an additional argument for federal question jurisdiction. FINRA contends that because the plaintiffs' suit implicates FINRA's SEC-approved Code of Arbitration Procedure, the court is required to decide whether FINRA breached a duty it owed Webb and Beversdorf under the securities laws. However, FINRA fails to identify a single provision of federal law that the court would have to interpret to resolve this case. Instead, the question before the court is whether FINRA breached its arbitration agreement, and no "inescapable" provision of federal law drives that analysis. The court reasoned that FINRA is regulated by the SEC, and its duties under the federal securities laws might come up, but that does not make federal law the "cornerstone" of the plaintiff's complaint. The Supreme Court has emphasized that a "federal role" is not enough. The court concluded that this is a state-law contract claim, and FINRA's effort to pull it within federal question jurisdiction fails. As a result, the 7th circuit vacated the judgment for lack of jurisdiction and remanded the case to the district court with instructions to remand to state court.

Jurisdictional Issues Resolved by the 2nd Circuit

Gottlieb v. United States SEC, 723 Fed. Appx. 17, 2018 U.S. App. LEXIS 1889, 2018 WL 507172 (2d Cir. January 23, 2018)

Appellant Phyllis Gottlieb ("Gottlieb") appeals from the district court's judgment dismissing her civil suit against the Securities and Exchange Commission ("SEC") and First American Title Insurance Company ("First American"). In 2003, the SEC obtained a securities fraud judgment against

Gottlieb's husband, Allen, for over $2 million. Allen Gottlieb made no voluntary payments towards satisfying the judgment, and the SEC attempted to collect on the judgment from his assets. While the judgment against Allen Gottlieb was outstanding, Phyllis Gottlieb sold a family home in Florida, and First American held the proceeds. After ascertaining that Allen Gottlieb was the true owner of the home, the SEC sought turnover of the funds. In response, Phyllis Gottlieb filed suit in Florida state court, seeking to obtain the funds from the home sale. The action was removed to the Southern District of Florida, and then transferred to the Southern District of New York. In the Southern District, Gottlieb failed to comply with three court orders to appear for a deposition in Miami. The SEC moved for sanctions, and Gottlieb, through counsel, agreed that dismissal of the suit was an appropriate remedy. Gottlieb now appeals from that dismissal. She argues on appeal that the district courts erred by transferring and later dismissing her suit, and that the judge was biased.

The court reviewed the issues of venue transfer and the imposition of Rule 37 sanctions for abuse of discretion. The court reasoned that the New York forum was more convenient for the SEC; First American did not object; all the parties had to appear in New York; and the convenience of the Florida forum for Gottlieb was diminished by the fact that she had moved, first to the Bahamas, and then to Brazil. Furthermore, the "first-filed rule" provides a presumption in favor of the Southern District of New York, where litigation over the funds from the Gottliebs' home sale was first initiated. *See, N. Y. Marine & Gen. Ins. Co. v. Lafarge N.A., Inc.,* 599 F.3d 102, 112 (2d Cir. 2010). The court further reasoned that in regard to the sanction of dismissal, Gottlieb, through counsel, agreed that dismissal was a proper sanction and she is bound by her concession. See *Gomez v. City of New York*, 805 F.3d 419, 424 (2d Cir. 2015) (a client is generally bound by the acts of her attorney). The presumption that the attorney speaks for the client is rebuttable when an attorney undertakes settlement or dismissal on the client's behalf. The court found that Gottlieb did not argue that her attorney acted without her authority when he agreed that dismissal was an appropriate remedy.

Lastly, the court reviewed for plain error the district court judge's refusal to recuse herself *sua sponte*. A judge must recuse from "any proceeding in which h[er] impartiality might reasonably be questioned" by an objective observer. *SEC v. Razmilovic*, 738 F.3d 14, 29 (2d Cir. 2013). Claims of judicial bias generally must be based on extrajudicial matters. See *Chen v. Chen Qualified Settlement Fund*, 552 F.3d 218, 227 (2d Cir. 2009) ("[A]dverse rulings, without more, will rarely suffice to provide a reasonable basis for questioning a judge's impartiality."). The court reasoned that other than dismissal of this case, Gottlieb does not suggest that district judge made any

statements or took any actions exhibiting bias; and the dismissal was clearly within the judge's discretion. Gottlieb's argument that she had no opportunity to object to the judge's appointment is unavailing because Gottlieb could have moved for recusal at any time and chose not to. The court considered Gottlieb's remaining arguments, found them to be without merit and accordingly affirmed the judgment of the district court.

Joint and Several Liability for Aiders in the Purchase of Illegal Securities Denied

Boyd v. Kingdom Trust Co., 2018-Ohio-3156 (Ohio 2018)

This case presents a certified question of Ohio law to the United States Court of Appeals for the Sixth Circuit. The question before the court is whether R.C. 1707.43, a provision of the Ohio Securities Act, imposes joint and several liability on persons who aided in the purchase of illegal securities but did not participate or aid in the sale of the illegal securities.

The Plaintiffs in this matter, are the alleged victims of a Ponzi scheme operated by a William Apostelos who formed Midwest Green Resources, L.L.C. and WMA Enterprises, L.L.C., as the vehicles for offering illegal securities to investors. Apostelos, allegedly pursued Plaintiffs to open self-directed individual retirement accounts ("IRAs") to invest in equity interests in Midwest Green Securities and promissory notes issued by WMA Enterprises. Once the accounts were established, Apostelos asked investors to direct the trust companies to purchase his securities or to execute powers-of-attorney giving him the ability to direct the trust companies to purchase his securities using the investors' IRA assets. Apostelos allegedly used the money raised from these investors to pay earlier investors and promoters and to fund his own personal expenses.

After the Ponzi scheme unraveled, Plaintiffs filed a class-action lawsuit seeking to hold the Trust companies liable for their alleged roles in the scheme. The complaint does not allege that the trust companies had any role in Apostelos's Ponzi scheme aside from purchasing the unlawful securities at the investors' direction. Furthermore, the complaint fails to allege that the trust companies knew or had reason to know that Apostelos was perpetrating a fraud. [1] The trust companies filed motions to dismiss for

[1] *Plaintiffs failed to state a claim for negligence or aiding and abetting breach of fiduciary duty which may have resulted in a different analysis by the court.*

failure to state a claim. The district court granted the motions. On appeal the court addresses whether the Ohio Securities Act extends joint and several liability to persons who aided in the purchase of illegal securities.

The court reasoned that Ohio authority offers no support for Plaintiffs' position. To the contrary, Ohio courts have consistently construed R.C. 1707.43(A) as imposing liability only on persons who played a role in the sale of unlawful securities, such as acting in concert with the seller of an unlawful investment. *Federated Mgmt. Co. v. Coopers & Lybrand*, 137 Ohio App.3d 366, 392-393, 738 N.E.2d 842 (10th Dist. 2000) (bank that directly participated in underwriting of investment and acted as financial adviser to issuer can be held liable under R.C. 1707.43); *Boland v. Hammond*, 144 Ohio App.3d 89, 94, 2001- Ohio 2680, 759 N.E.2d 789 (4th Dist. 2001) (defendant who relayed proposed terms of sale to investors, arranged meetings between seller and investors, and distributed promissory notes to investors can be held liable under R.C. 1707.43).

Ohio courts have held that a financial institution's mere participation in a transaction, absent any aid or participation in the sale of illegal securities, does not give rise to liability under R.C. 1707.43(A). Therefore, the court concluded that R.C. 1707.43 does not impose joint and several liability on a person who, acting as the custodian of a self-directed IRA, purchases illegal securities on behalf of and at the direction of the owner.

Supreme Court Deems SEC In-House Judge Hiring Unconstitutional

Lucia v. SEC, 138 S. Ct. 2044, 201 L. Ed. 2d 464 (2018)

The Appointments Clause of the Constitution lays out the permissible methods of appointing "Officers of the United States," a class of government officials distinct from mere employees. Art. II, §2, cl. 2. This case required the court to decide whether administrative law judges (ALJs) of the Securities and Exchange Commission (SEC or Commission) qualify as such "Officers." The SEC has statutory authority to enforce the nation's securities laws. One way it can do so is by instituting an administrative proceeding against an alleged wrongdoer. By law, the Commission may itself preside over such a proceeding. See 17 CFR §201.110 (2017). The Commission also may, and typically does, delegate that task to an ALJ. The SEC currently has five ALJs and other staff members, rather than the Commission selected them all. An

ALJ assigned to hear an SEC enforcement action has extensive powers—the "authority to do all things necessary and appropriate to discharge his or her duties" and ensure a "fair and orderly" adversarial proceeding. §§201.111, 200.14(a). An SEC ALJ exercises authority "comparable to" that of a federal district judge conducting a bench trial. *Butz* v. *Economou*, 438 U. S. 478, 513, 98 S. Ct. 2894, 57 L. Ed. 2d 895 (1978).

This case began when the SEC instituted an administrative proceeding against petitioner Raymond Lucia and his investment company. Lucia marketed a retirement savings strategy called "Buckets of Money." In the SEC's view, Lucia used misleading slideshow presentations to deceive prospective clients. The SEC charged Lucia under the Investment Advisers Act, §80b-1 *et seq.*, and assigned ALJ Elliot to adjudicate the case. After nine days of testimony and argument, Judge Elliot issued an initial decision concluding that Lucia had violated the Act and imposing sanctions, including civil penalties of $300,000 and a lifetime bar from the investment industry. On appeal to the SEC, Lucia argued that the administrative proceeding was invalid because Judge Elliot had not been constitutionally appointed. The Commission rejected Lucia's argument and argued instead that the SEC's ALJs are not "Officers of the United States" but instead, they are "mere employees"—officials with lesser responsibilities who fall outside the Appointments Clause's requirements.

The sole question before the Supreme Court was whether the Commission's ALJs are "Officers of the United States" or simply employees of the Federal Government. The Appointments Clause prescribes the exclusive means of appointing "Officers." Only the President, a court of law, or a head of department can do so. See Art. II, §2, cl. 2. All parties agree, none of those actors appointed Judge Elliot before he heard Lucia's case; instead, SEC staff members gave him an ALJ slot. The court reasoned that the Commission's ALJs hold a continuing office established by law. The court further reasoned that the Commission's ALJs exercise significant discretion when carrying out important functions. Lastly, at the close of proceedings, ALJs issue decisions. Based on the forgoing, the court found that Commission's ALJs are "Officers of the United States," subject to the Appointments Clause. The court further found that Judge Elliot heard and decided Lucia's case without the appointment the Clause requires.

As a result, the court held that "one who makes a timely challenge to the constitutional validity of the appointment of an officer who adjudicates his case" is entitled to relief. *Ryder* v. *United States*, 515 U. S. 177, 182-183, 115 S. Ct. 2031, 132 L. Ed. 2d 136 (1995). Lucia made a timely challenge when he contested the validity of Judge Elliot's appointment before the Commission,

and continued pressing that claim in the Court of Appeals and this Court. The court held that the "appropriate" remedy for an adjudication tainted with an appointments violation is a new "hearing before a properly appointed" official. Accordingly, the Supreme Court reversed the judgment of the Court of Appeals and remand the case for further proceedings consistent with this opinion.

Statute of Limitations Applied to the Martin Act

People v. Credit Suisse Sec. (USA) LLC, 2018 N.Y. LEXIS 1451 (N.Y. June 12, 2018)

The Attorney General commenced this action in November 2012 asserting that the issuance of residential mortgage-backed securities by defendants Credit Suisse Securities (USA) LLC and affiliated entities (Credit Suisse) in 2006 and 2007 violated the Martin Act. The complaint alleges that defendants committed multiple fraudulent and deceptive acts in connection with the creation and sale of residential mortgage-backed securities ("RMBS"). In particular, the Attorney General claimed that defendants led investors to believe that they had "carefully evaluated — and would continue to monitor" the quality of loans underlying the RMBS. However, the complaint asserts that defendants were aware of "pervasive flaws in the screening process" for such loans but failed to disclose them to investors. Further, defendants purportedly encouraged originators to deliver defective loans based on an "incentives" program. The Attorney General contended defendants misrepresented the quality of the mortgage loans underlying the securities as well as the due diligence process. After describing the alleged misconduct in some detail, the first cause of action states that defendants' acts and practices violated Article 23-A of the General Business Law (the Martin Act). In a second cause of action incorporating by reference the same allegations, the complaint alleges defendants engaged in repeated fraudulent or illegal acts in violation of the Martin Act.

Defendants moved to dismiss the complaint arguing, among other things, that the action was time-barred because the operative statute of limitations is three years. The Attorney General countered that the action was timely because Martin Act claims are governed by the six-year limitations period. Alternatively, the Attorney General asserted that a six-year limitations period was applicable here because the complaint plead the elements of common law fraud.

The first issue before the court was whether the Martin Act claims are governed by CPLR 214(2), imposing a three-year statute of limitations, or the six-year limitations period implied by CPLR 213(1) or 213(8). CPLR 214(2) generally imposes a three-year limitation period for an action to recover upon a liability, penalty or forfeiture created or imposed by statute. An action based upon fraud receives a six-year statute of limitations pursuant to CPLR 213(8). CPLR 213(1) is a residuary provision applicable to "an action for which no limitation is specifically prescribed by law."

The court reasoned that the Martin Act imposes numerous obligations or liabilities that did not exist at common law. Therefore, the court concluded that the three-year statute of limitations in CPLR 214(2) which is applicable to "a liability, penalty or forfeiture created or imposed by statute" governs Martin Act claims. Accordingly, the court held that the order of the Appellate Division should be modified by granting defendant's motion to dismiss the Martin Act claims as time barred and remitting the case to Supreme Court for further proceedings in accordance with this opinion.