

February 9, 2010

## Georgia Supreme Court Recognizes a Cause of Action for “Holders” of Securities and Limited Duties in Favor of Non-Discretionary Account Customers

In response to three questions certified to it by the U.S. Court of Appeals for the Second Circuit, on February 8, 2010, the Georgia Supreme Court held that, under Georgia common law: (1) “holder” claims are actionable; (2) plaintiffs in misrepresentation or omission claims involving publicly traded securities must prove loss causation; and (3) a limited fiduciary relationship exists between registered representatives and clients, even in non-discretionary accounts.<sup>1</sup> The Court’s Opinion represents a significant departure from existing federal law, and is described further below.

### “Holder” Claims Are Actionable Under Georgia Common Law

The first question certified to the Georgia Supreme Court is whether Georgia common law recognizes fraud claims based on forbearance in the sale of publicly traded securities (commonly known as “holder” claims). The Court had no trouble finding that Georgia common law does indeed recognize “holder” claims. Justice Carley, writing for a unanimous Court, noted that “it is well settled that one of the elements of the tort of fraud in Georgia is an ‘intention to induce the plaintiff to act *or refrain from acting.*’ ”<sup>2</sup> Georgia’s well-settled elements for fraud claims, the Court continued, are consistent with both the Restatement (Second) of Torts § 525 and the general rule that “‘induced forbearance can be the basis for tort liability.’ ”<sup>3</sup> The Court found further support for its holding in *Blue Chip Stamps v. Manor Drug Stores*, a case in which the U.S. Supreme Court held that “holder” claims were not available under Rule 10(b)(5), promulgated by the Securities and Exchange Commission under § 10(b) of the Securities Exchange Act of 1934, but also noted that “holder” claims may be available under State law.<sup>4</sup> The Court also noted that the Georgia Court of Appeals had previously acknowledged that “evidence of fraud . . . includes evidence which supported the conclusion that [the plaintiffs] were fraudulently induced into making *and keeping* their investments.”<sup>5</sup>

“Holder” claims under Georgia law are not without limitations, however. The Court imposed two limitations: direct communication and specific reliance. The “direct communication” limitation requires that “‘plaintiffs allege that the misrepresentations were directed at them to their injury.’ ”<sup>6</sup> The “specific reliance” limitation requires that plaintiffs “‘allege actions, as distinguished from unspoken or unrecorded thoughts and decisions, that would indicate that the plaintiff actually relied on the misrepresentations.’ ”<sup>7</sup>

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<sup>1</sup> *Holmes v. Grubman*, SO9Q1585, 2010 WL 424225 (Ga. Feb. 8, 2010).

<sup>2</sup> *Holmes v. Grubman*, 2010 WL 424225 (quoting *Stiefel v. Schick*, 260 Ga. 638, 639 (1990)).

<sup>3</sup> *Id.* (quoting *Small v. Fritz Cos.*, 65 P.3d 1255, 1259 (Cal. 2003)).

<sup>4</sup> *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730-31, 738 (1975).

<sup>5</sup> *Holmes v. Grubman*, 2010 WL 424225 (quoting *Argentum Int'l v. Woods*, 280 Ga. App. 440, 445 (2006)).

<sup>6</sup> *Id.* (quoting *Gutman v. Howard Savings Bank*, 748 F. Supp. 254, 265 (D.N.J. 1990)).

<sup>7</sup> *Id.* (quoting *Small v. Fritz Cos.*, 65 P.3d at 1265).

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Finally, though the Second Circuit's certified question related only to fraud claims, the Court held that negligent misrepresentation claims, subject to the same limitations, can also be based on forbearance in the sale of publicly traded securities.<sup>8</sup>

### Georgia Law Requires Plaintiffs to Establish Loss Causation for Misrepresentation or Omission Claims Relating to Publicly Traded Securities

The second certified question is whether, with respect to a tort claim based on misrepresentations or omissions concerning publicly traded securities, proximate cause is adequately pleaded under Georgia law when a plaintiff alleges that his injury was a reasonably foreseeable result of the defendant's false or misleading statements but does not allege that the concealed fact caused a drop in the price of the security. In response, the Court, after recognizing that it was not authorized to determine what allegations are necessary for a pleading to be adequate in a federal diversity action, addressed the burden placed on a plaintiff at trial to prove proximate cause with respect to a tort claim based on misrepresentations or omissions concerning publicly traded securities. The Court began its analysis by noting that it has long been the law in Georgia that "in order to recover in tort for fraud, the plaintiff must prove that he sustained loss or damage as the proximate result of the alleged misrepresentations."<sup>9</sup> The Court then noted that, unlike "holder" claims, Georgia's common law requirement that plaintiffs prove proximate causation is in accord with Supreme Court precedent. In *Dura Pharmaceuticals v. Broudo*, 544 U.S. 336, 343-44 (2005), the Supreme Court adopted common law causation requirements for fraud claims in harmony with those already extant in Georgia.<sup>10</sup> According to the Court, "'Dura requires that a plaintiff show that it was th[e] revelation [of the concealed truth] that caused the loss and not one of the 'tangle of factors' that affect price.'"<sup>11</sup>

### Brokers May Owe Limited Fiduciary Duties to Clients Holding Non-Discretionary Accounts

The final question is whether a fiduciary duty exists under Georgia law between a brokerage firm and the holder of a non-discretionary account.<sup>12</sup> The Court recognized the limited scope of the fiduciary duty that a broker may owe to a client holding a non-discretionary account and recognized circumstances when a broker would owe a "heightened" duty to clients holding non-discretionary accounts. Typically, a broker owes a limited duty to non-discretionary clients, "'including the duty to transact business only after receiving prior authorization from the client and the duty not to misrepresent any fact material to the transaction.'"<sup>13</sup> The Court approved of this standard and noted that brokers "generally have a heightened duty, even to the holder of a non-discretionary account, when recommending an investment which the holder has previously rejected or as to which the broker has a conflict of interest."<sup>14</sup>

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<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* (quoting *In re Williams Secs. Litig. – WCG Subclass*, 558 F.3d 1130, 1138 (10th Cir. 2009)).

<sup>12</sup> *Holmes v. Grubman*, 568 F.3d 329, 340-41 (2d Cir. 2009).

<sup>13</sup> *Id.* (quoting *Glisson v. Freeman*, 243 Ga. App. 92, 99 (2000)).

<sup>14</sup> *Id.* (citing *Leib v. Merrill Lynch, Pierce, Fenner & Smith*, 461 F. Supp. 951, 953 (E.D. Mich. 1978)).



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