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THE USE OF SECURITIES AND EXCHANGE COMMISSION DECISIONS AS PRECEDENT IN ARBITRATION PROCEEDINGS

Timothy J. O'Connor

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INTRODUCTION

Attorneys representing parties in arbitration proceedings are being increasingly asked by arbitration panels to produce concise case citations to support their clients' positions in securities arbitration proceedings. Unlike belabored briefs which might be required in a securities fraud case venued in Federal Court, many arbitrators are simply looking for one or two cases to support an award which might be made in any given case that can be supported by viable case law. The demands made by arbitrators upon counsel in securities arbitration proceedings for the production of legal briefs and citation to applicable case law can run a range from the provision of a single photocopy of a case to a demand for a brief along federal court guidelines with a table of contents, list of authorities, footnotes and appendices. Decisions of the Securities and Exchange Commission offer guidance to the practitioner on virtually any issue involving supervisory red flags.

In the Matter of Royal Alliance Associates, Inc., 1997 SEC Lexis 113 at page 14 (1/15/97), the Commissioner noted that:

> [m]any failure-to-supervise cases involved indicators of misconduct, or "red flags", that should have immediately alerted management to potential wrong doing...[i]n circumstances where a firm's compliance and supervision system is inadequate to discover the indications of problematic conduct, the personal responsibility for supervision cannot be fulfilled by a supervisor who is simply unaware of the indicators.

This article addresses one dozen separate "red flags" which commonly arise in customer-broker/dealer disputes and the manner in which administrative decisions of the Securities and Exchange Commission have dealt with circumstances where these "red flags" have been raised. In

the Matter of Arthur James Huff, Admin. Proc. File No. 3-6700, Securities Exchange Act of 1934, 1987 SEC Lexis 3013 at pages 9-10 (12/15/87), it was noted that "...a branch manager is the first line of defense when it comes to supervision of registered representatives and endeavoring to assure their compliance with applicable laws and regulations".

As more and more customer claims are resolved in Arbitration proceedings versus court venued proceedings, there is less new case law being made addressing the obligation of a brokerage firm to the investing public. Further, when arbitrators seek case law guidance on damages issues many of the court venued cases cited are cases which are 10b-5 damages based on prospectus fraud, insider trading or market theory damages. Some arbitrators do not even want to be provided with any case authority and expressly state so on the record in arbitration proceedings. Further, this author suggests that the private Securities Reform Act of 1995 will have a chilling effect on the various District Courts and various Federal Circuit Courts of Appeal as being the source of well articulated decisional law protecting the rights of small investors filing claims under the Federal Securities Laws. A significant exception, however, would be the decision of the United States District Court for the Northern District of New York in Capital District Physicians Health Plan v. O'Higgins, 939 F. Supp. 992 (N.D.N.Y. 1996) motion for reconsideration denied 951 F. Supp. 352 (N.D.N.Y. 1997). This represents a decision which will afford Arbitration Panels many insights particularly on issues of common law theories of recovery, ratification and damages. (See Appendix A).

Establishing the duty of a branch manager to provide proper supervision of his or her brokers is often an essential part of any claimant's case. The question often arises in arbitration proceedings as to just how far must a branch manager go towards assuring the proper supervision of a broker. Although Rule 3010 of the NASD Manual Conduct Rules (formerly Section 27 of the NASD Rules

of Fair Practice) and the Rules of the New York Stock Exchange set forth general rules of supervision they do not fully articulate the specifics of just what is required of a branch manager when supervising a broker engaging in questionable activity. Further, most State and Federal cases which touch upon issues of supervision fall short of specifying the exact steps which a branch manager should have taken in a certain case in order to have prevented customer victimization.

Many arbitrators lack extensive experience with the securities industry and are not conversant with the job function of a branch manager and are therefore unable to articulate what should have been done in a particular situation. Without any authoritative guidance the question of what the branch manager should or should not have done is often left to a battle of expert witnesses. Decisions of the Securities and Exchange Commission in administrative proceedings can provide a detailed description required of a branch manager in any number of situations. These decisions can be accessed on Lexis or West Law and are also available in most law libraries in hard copy through the Commerce Clearing House Federal Securities Law Reporter or the SEC Docket, the official reporter. A diligent search through these decisions should provide counsel with persuasive if not controlling authority for the steps which a branch manager should have taken to assure that the interests of the customer were being protected at all times.

Many of these administrative decisions speak for the proposition that once a branch manager or compliance officer is on inquiry notice of any possible improprieties he or she then has an obligation to make an independent inquiry of transactions in customer accounts without relying on the representations of the broker. In fact, many of these decisions suggest the simple expedient of branch manager contact with the client by telephone to verify the representations which the broker has made to the branch manager regarding a customer's account. Such a simple step would be

particularly helpful in verifying a broker's representations to the branch manager that certain trades in a customer's account were being made on an unsolicited versus a solicitated basis. A simple phone call by the branch manager to the customer can also serve to verify the accuracy of the net worth, age, employment and investment experience representations on the new account form. Turning a blind eye to questionable account activity can lead to dangerous consequences for the branch manager, branch offices and the firm.

This article addresses the findings of certain administrative decisions of the Securities and Exchange Commission addressing one dozen separate areas of concern or red flags commonly addressed in customer-broker/dealer disputes which articulate the specific obligations of the branch manager in commonly addressed circumstances as follows:

1. The duty of the branch manager to keep proper books and records and to review specific documentation to detect irregularities and proper follow through with activity letters and active accounts.

2. The duty of the branch manager to detect criminal activity.

3. Account activity at variance with customer information on the new account form.

4. Are the trades in the customer's account really unsolicited?

5. Excessive account concentration and trading activity in a single stock.

6. The obligation of supervision of investment advisors under the Investment Advisors Act of 1940.

7. The obligation to supervise financial planners.

8. The duty of supervision extends well beyond the branch office.

9. The duty of the branch manager to meet with the customer in person or to contact the customer by telephone.

10. The duty of the branch manger to detect illegal "cross-selling" and "no net sales practices".

11. The duty to assure that the customer is being provided with proper "break-point" and rights of accumulation information on mutual fund purchases.

12. The duty to assure proper supervision of satellite branches or single broker branch offices.

(i) The duty of the branch manager to keep proper books and records and to review specific documentation to detect irregularities and proper follow through with activity letters and active accounts.

The theory of liability in many arbitration proceedings often hinges on a determination as to the specific documentation which the branch manager should have reviewed in order to make a showing of proper and adequate supervision of the registered representative. In the Matter of Sandra Logay, Admin. Proc. File no. 3-8969, S.E.C. Securities Exchange Act of 1934, Release No. 36924, 1996 Sec Lexis 584 (3/6/96). The commission determined that the former branch manager of the Chesterfield, Missouri branch of Prudential Securities, Inc., failed to reasonably supervise a registered representative so as to prevent violations of the anti-fraud provisions of the Federal Securities Law by:

> ...failing to adequately review and analyze many documents necessary for reasonable supervision of the registered representative including, but not limited to, such items as customer complaints, new account forms, the registered representatives holding pages outlining the trading in his customer accounts, monthly customer account statements, fund transfer records, customer order tickets, revenue reports, active account reports, commission to equity reports and manager supervision guide or "MSG" reports.

This cook's list of required documentation for review by the branch manager is by no means an exclusive list but the ruling in the Matter of Sandra Logay, supra, articulated the need for the branch manager to make a detailed review of the above itemized documents which are normally required for production by brokerage firms in the discovery phase of arbitrations.

Activity letters, letters prepared by the branch office seeking a customer's acknowledgment of excessive trading activity or losses in his or her account, and the manner in which they are prepared, delivered to the client and received back by the firm often provide numerous "red flags" to the branch manager. Once accounts have been singled out for activity letters, common sense requires that branch managers follow the activity letter from its preparation through its ultimate receipt from the client in order to detect any irregularities. Indeed, the mere failure to receive a return activity letter has been determined to constitute cause enough for a branch manager to make direct contact with a non-responding customer. In the Matter of Arthur James Huff, 1987 SEC Lexis 3013 (1987) at page 16, the branch manager there was faulted for permitting a wholesale breakdown in the activity letter process as follows:

> Huber (the branch manager) received only nine out of the twelve activity letters that were purportedly sent to Greenman's customers...Huber did not contact the customers who apparently failed to respond...[s]uch contacts by Huber were particularly called for here since Huber had allowed Greenman (the broker) to send out the letters himself rather than following the suggested practice of having a branch manager send them out.

The decision went on to note that the broker there succeeded in preparing another set of activity letters, sent to pre-arranged post office boxes, to which he had forged his customers signatures.

In the Matter of Prudential Securities, Inc., Admin. Proc. File No. 3-8209, Securities Exchange Act of 1934, Release No. 33082, 1993 SEC Lexis 2866 (10/21/93), involved an order of

the Securities and Exchange Commission with a determination of lax supervisory practices on the part of Prudential Securities which dealt with, *inter alia*, the failure of branch office managers to follow through with active account reports. In faulting, Prudential, the decision noted that:

> [m]any customers were not contacted by branch offices managers, even though their accounts repeatedly appeared on active account reports...[i]n virtually all cases, meaningful contact could have detected and prevented violations...PSI experienced a serious breakdown in its active account review procedure (1993 SEC Lexis 2866 at page 64)

The simple expedient of client contact by the branch manager, it was determined, would have prevented trading improprieties being engaged in by brokers in branch offices.

(ii) The duty of the branch manager to detect criminal activity.

Many arbitration claims involve instances of a broker theft involving customer checks or securities. Such claims are often met with the defense that a firm is not liable for the criminal acts of its registered representative acting outside the scope of employment. Broker theft of customer monies, however, is a recurrent problem and a problem which often can be prevented through proper supervisory practices.

In the Matter of Charles Schwab & Co., Inc., Admin. Proc File No. 3-6222, SEC 1983 SEC Lexis 2821 (12/28/83), dealt with a fact pattern involving a ponzi scheme perpetrated by a broker who deposited over $342,000.00 worth of investor checks into her personal securities account at Charles Schwab. The Administrative Law Judge had determined that the branch manager exercised inadequate supervision with respect to third-party-check procedures and the training of cashiers at the branch office in question. The decision also determined that the branch manager failed to make a proper investigation of the broker after becoming aware of the broker's "clearly erratic behavior", particularly as related to the broker's personal adverse financial circumstances. (Matter of Charles

Schwab & Co., Inc., supra, .1983 SEC Lexis 2821 at pages 35-36. This decision also cited supervisory shortcomings which involved the failure of the office cashier to obtain a release from specified customers who had purportedly deposited cashier checks with their names noted on the face of the cashier checks which were deposited into the account of the broker, as such releases are required by industry practice. 1983 SEC Lexis 2821 at pages 13-14.

In the Matter of Robert Hoffman, Walston & Co., Inc., et al, Admin. Proc. File No. 3-3492 SEC, 1974 SEC Lexis 3630 (6/28/74), involved the supervisory failings of a branch manager who permitted a registered representative to remain in the office as a broker well after the discovery of the fact that the broker had lied about his educational experience and financial history which, it was determined, "...should have warned the respondents of his propensity to lie when he felt it was necessary and that respondents should have exercised special care in his supervision." 1974 SEC Lexis 3630 at page 11. The broker was determined to have engaged in numerous unauthorized trades in customer accounts as well as having converted customer funds for his own use, as well as having made numerous unauthorized withdrawals of monies from various customer accounts. Despite numerous customer complaints, the branch manager failed to engage in close supervision over the broker and failed to make direct contacts with the customers. The broker there explained away a number of questionable trades in various customer accounts as "trade adjustments" to which proper inquiry was also not made. Ultimately, the decision of the Administrative Law Judge agreed with the contentions of the Division that the broker/dealer "did not have supervisory procedures requiring confirmation by direct contact with customers when matters indicating this conduct by account executives were revealed...nor was there any system for following up with the customer to determine

whether there were special problems requiring supervisory intervention", 1974 SEC Lexis 3630 at page 30-31.

The decision in the Matter of Robert Hoffman, Walston & Co., Inc., et al, supra, went on to note at 1974 SEC Lexis 3630 at pages 37-38 that:

> While Hoffman was obviously not authorized to engage in criminal activities and other violations of the Securities Act and the Exchange Act, the doctrine of *respondeat superior* still applies to his activities and the Registrant is responsible for the violations committed by him while he was in Registrant's employ. These violations were willful within the meaning of the Exchange Act (citing Sutro Bros. & Co., 41 S.E.C. 470 (1973) and Tager v. S.E.C., 344F 2d 5, 8 (2nd Cir. 1965), affirming, Sidney Tager, Sec. Exch. Act Rel. No. 7368 (7/14/64); accord Harry Marks, 25 S.E.C. 208, 220 (1947); George W. Chilian, 37 S.E.C. 384 (1956); E.W. Hughes & Co., 27 S.E.C. 629 (1948); Hughes v. S.E.C., 174 F 2d 969 (C.A. D. C. 1949); Shuck & Co., 38 S.E.C. 69 (1957); Carl M. Lobe Rhoades & Co., 38 S.E.C. 843 (1959); Ira Haupt & Co., 23 S.E. C. 589, 606 (1946).

Another branch manager supervisory failing which enables a broker to engage in criminal activity involves the use of post office boxes. This scenario was addressed in the Matter of Arthur James Huff, 1987 SEC Lexis 3013, which addressed the supervisory failings within a branch office and compliance department which permitted a broker to engage in a complex scheme to defraud by using post office box numbers as mailing addresses for the various victims of this scheme. The decision noted that "...Huber (the branch manager) did not do anything to verify independently any of Greenman's explanations for the similar addresses on his customer accounts either then or later, when additional information raising questions about Greenman's option trading program came to Huber's attention", 1987 SEC Lexis 3013 at page 12. In the same case, the Senior Registered Options Principal in the Compliance Department was also faulted for failing to make further inquiry despite the fact that he acknowledged that the use of post offices boxes as customer addresses was

a "red flag", noting that "...he did not attempt to obtain a home or business address for any of those customer accounts", 1987 Sec Lexis 3013 at page 41.

(iii) Account trading activity at variance with customer information on the new account form - Matter of Prudential Securities.

When trades in a customer's account exceed the stated assets in a customer account agreement, the branch manager has a duty to intervene and make a thorough inquiry. In Matter of Prudential Securities, 34 SEC Docket 1094, 1986 W.L. 72873 at page 76, the Securities and Exchange Commission noted that ". . . in two instances where information contained in the customer's option agreement was accurate, Kalil (the broker) told Solomon (the branch manager) that the customers had greater assets than the customers disclosed in their options agreements in order to justify excessive trading for these accounts . . . based upon Kalil's representations, Solomon permitted options trading in these accounts to continue".

In holding Prudential responsible, the Commission cited authority for holding branch managers responsible for failure of supervision in instances where they "...relied solely upon representations made by the account executive in response to inquiries concerning certain trading". See Bache Halsey Stuart Shields, Inc., et al., SEC 1934 Docket Release No. 19725 (May 3, 1983). In the case of the Matter of the Application of Bradford John Titus, 63 SEC Docket 926, 1996 W.L. 705335 (S.E.C.), the Securities and Exchange Commission addressed a situation wherein a broker told his superiors that trades made in an elderly customer's account were in fact approved by her, when in fact, they were not and further, despite the fact that the broker there made trades well in excess of the client's stated financial resources, the broker told his supervisors that his client had greater financial resources than were previously disclosed in her new account form. In making a

determination that the brokerage firm had violated Article III, Sections 1 and 27 of the NASD Manual Rules of Fair Practice, the commission noted that:

> Where there are ample indications of irregularities and misconduct by a registered representative, such as are displayed here, we have held that it is "especially imperative" that those in authority "exercise particular vigilance" over the registered representative (citing Wedbush Securities, Inc., 48 S.E.C. 963 (1988).

(iv) Are the trades in the customer's account really unsolicited?

Branch managers have a duty to make independent inquiry when a broker insists that excessive activity in a customers account is unsolicited when the nature of the trading activity appears otherwise. In the Matter of First Albany Corporation, 51 SEC Docket 87, 50 SEC 890, Release No. 34-30515, 1992 W.L. 64040 (SEC), the Securities and Exchange Commission addressed the supervisory failures of the Boston Offices of First Albany Corporation involving a registered representative who accumulated concentrated positions in a speculative security. The broker there advised his branch manager that his trading of hundreds of thousands of shares of this stock in numerous customer accounts was unsolicited. In faulting the branch manager for failing to conduct any inquiry to determine whether the registered representative's purchases in the stock were in fact solicited transactions, it was determined that the branch manager "failed reasonably to supervise the registered representative by failing to respond reasonably to recognized indications of wrongdoing".

Further, the SEC faulted First Albany's Chief Compliance Officer noting that he:

> ...accepted the registered representative's statement that all the trades were unsolicited without performing any further inquiry. The volume of the trading (more than 100 trades) over a three month period, however, necessitated further inquiry. thereby failing to prevent violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and 10-5 thereunder.

It has been also held that compliance department personnel such as a Senior Registered Options Principal responsible for oversight and supervision of a branch office and a branch manager also have a responsibility to make inquiry as to whether or not, in certain circumstances, trading activity is in fact "unsolicited" when trading activity tends to indicate otherwise. In the Matter of Arthur James Huff, Admin. Proc. File No. 3-6700, Securities Exchange Act of 1934, 1987 SEC Lexis 3013 at page 42 (12/15/87), the Senior Registered Options Principal in the compliance department was faulted for failing to make inquiry regarding a brokerage claim that certain orders were, in fact, unsolicited. The decision noted that:

> [a]lthough Greenman (the broker) told Huff (the SROP in the compliance department) the orders were unsolicited, they were in fact "discretionary" orders although, as previously noted herein, proper authorization for discretionary trading had not been obtained...Huff should have known or strongly suspected this since the nature of Greenman's program, as Huff understood it from the Paine memorandum and otherwise, was such that Greenman suggested trades to customers...Huff acted as if he were reluctant to turn over a stone of suspicion for fear of what might turn up underneath.

This decision amply points out that branch managers and compliance personnel cannot rely solely on the representations of the broker regarding the nature of solicitation of trades.

The false marking of order tickets as unsolicited when they are in fact solicited has been held to constitute a violation of the Federal Securities Laws. See in the Matter of Wall Street West, Inc., et al, Admin. Proc. File No. 3-6119; 8-22329; 8-7303, 1983 Sec Lexis 2822 at page 48, aff'd 718 F2 973 (10th Cir 1983), citing Haight & Co., Inc., et al., 44 S.E.C. 481 (1971), wherein the Commission noted that: "...we think it is clear that the use of the term "unsolicited" where the order was in fact solicited constituted a false entry which could hamper this Commission in its investigatory functions".

(v) Excessive account concentration and trading activity in a single stock - Matter of Dean Witter Reynolds, Inc.

In a situation where a particular broker appears to have "fallen in love" with a particular stock it has been determined that the branch manager has a heightened responsibility to make detailed inquiry of the facts and circumstances involving the accumulation of substantial positions in any one stock in customer accounts. In addition to concerns relating to customer victimization there may also be regulatory considerations which might require a 13D filing when share accumulation in any discernable mutually situated block of investors or customers exceeds 5% of the public float.

In the Matter of Dean Witter Reynolds, Inc., Administrative Proceeding File No. 3-7072, September 30, 1988, 41 SEC Docket 1307, 49 SEC 956, Release No. 34-26144, 1988 W.L. 240347 (S.E.C.), the Securities and Exchange Commission addressed a situation involving a registered representative in the Wayzata, Minnesota offices of Dean Witter who had accumulated a sizeable percentage of the float of Continental, a thinly traded AMEX stock. Noting that the number of shares held by the registered representatives in his accounts had increased steadily from 86,207 shares (9.6% of the float) to an office-wide position of 24.4% of the float in November of 1983, the Commission found that Dean Witter failed to reasonably supervise the manager and the registered representative, with a view toward preventing violations of Section 17(a)(1), 17(a)(2) and 17(a)(3) of the Securities Act and Section 10(b) of the Exchange Act and 10-b thereunder noting *inter alia*:

> At no time during the build up of this position did Dean Witter direct its branch manager or anyone else to contact clients to determine the nature of the statements made by the registered representative to these clients during a solicitation. Such inquiry, if made, may have revealed the misrepresentations and/or omissions made by the registered representative to solicit his customers.

These events show that Dean Witter did not effectively supervise the branch manger, who in turn, failed to fulfill some of his supervisory functions. The decision went on to note that:

> Once the Compliance Department became aware of the stock concentration and directed that trading restrictions be imposed, its steps to implement and enforce these restrictions were not effective.

Citing Smith, Barney, Harris, Upham & Co., Inc. et al, Exchange Act Release No. 21813 (3/5/85) the Commission noted that "[t]here must be adequate follow-up and review when a firm's own procedures detect irregularities or unusual trading activity in a branch office . . ."

In the Matter of Frank J. Crimmins, Admin Proc. File No. 3-3261, 1973 SEC Lexis 3508 (8/31/73), aff'd 368 F. Supp. 270 (S.D.N.Y. 1973) aff'd 503 F 2d 560 (2d Cir. 1974), involved a branch manager who owned a considerable position in a particular security which was also being sold by brokers under his supervision in excessive concentrations. In faulting the branch manager for improper supervisory practices the decision noted that "the record establishes that Crimmins (the branch manager) never asked his salesman what they were telling the customers to whom they were recommending ESP (the stock in question)", (1973 SEC Lexis 3508 at page 26). In determining that the sales manager had failed to disclose his personal interest to customers, as well as the holdings of the broker under his supervision who solicited concentrated purchase transactions and shares of ESP stock the decision noted that:

> ...because of Crimmins' personal interest in ESP and because of his closeness to [the brokers] who also had personal interest in ESP, Crimmins should have been especially mindful of the need to insure that such personal interests were fully disclosed to customers to whom the stock was being recommended...[i]nstead, very surprisingly, Crimmins was of the quite erroneous belief that such personal holdings did not have to be disclosed.

The Administrative Law Judge in the Matter of Frank J. Crimmins, supra, determined that the manager had failed to reasonably supervise the trading activity of his brokers in shares of ESP stock with a view to preventing anti-fraud violations of Section 15(b)(5)(E) of the Exchange Act.

(vi) Responsibility of broker/dealers for activities of Investment Advisors under the Investment Advisors Act of 1940.

In the Matter of Shearson, Lehman Brothers, Inc., 36 SEC Docket 754, 49 SEC 619, Admin. Proc. File No. 3-6733 (8-12324)(801-00517), Release No. 34-23640 (Sept. 24, 1986), the United Securities and Exchange Commission determined that Shearson "failed reasonably to supervise" its registered representatives who were registered as investment advisors "with a view to preventing violations of Section 206 of the Advisor's Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, thereby violating Section 15(b)(4)(E) of the Exchange Act and further directed that Shearson "engage an independent consultant with, with expertise in broker/dealer operations and acceptable to the Commission, who shall review and examine Shearson's supervisory and compliance procedures" with respect to eight separately enumerated points.

With respect to the supervisory shortcomings in the Utica Shearson Office, the decision noted in footnote as follows:

> "If a firm's established procedures for preventing and detecting fraud by employees come down in the last analysis to taking the employee's word on explanations when questionable events are looked into, then the procedures cannot be very effective." citing in the Matter of Charles Schwab & Co., Inc. [1983 - 1984 Transfer Binder] Fed. Sec. Law Rep. (CCH) paragraph 83, 469 at 86 506 (Dec. 28, 1983).

The decision also noted that the branch manager

> "sent incorrect letters as a result of monthly activity runs which automatically flag active accounts . . . although the responses to these letters were to go to compliance, there is no indication that Compliances' failure to receive any communication

caused it to look further. Had it been pursued, Compliance would have known that the wrong letters were sent".

(vii) The emergence of the concept of financial planning has seen administrative decisions addressing the obligations of branch managers supervising financial planners.

In the Matter of Hodgdon & Co., Admin. Proc. File No. 3-533, 1969 SEC Lexis 2920 (5/15/69), the Commission determined that the supervisor had abdicated his supervisory responsibilities by failing to set up:

> ...machinery which would enable it to ascertain whether the financial plans were being property administered...salesmen were required to present financial plans for review only for the first year after completion of the basic training course...[t]hereafter, the submission for review of such plans as may have involved the complex problems was left to the salesmen's discretion.

The Commission went on to note that the failure of the supervisor to supervise financial plans was due to the fact "[h]is activities were directed primarily toward supervision of the firms trading, the consideration of all offers for underwritings and the daily review of order tickets".

The Commission went on to note that numerous customers had excessive concentrations of securities for which the broker/dealer was an underwriter or securities that were sold out of the broker/dealer trading account as a principal, as well as excessive concentrations of speculative real estates syndications and found that:

> [t]he foregoing demonstrates registrant's inordinate concentration on recommendations and selections of securities for its clients from which it could derive the greatest amount of compensation...[c]ertainly, registrant's recommendations could have been made from the virtually unlimited choice available to it on the exchanges and over-the-counter...[i]n that event, of course, registrant would have been restricted to the lesser compensation to be realized from agency transactions. (See Hodgdon & Co., Admin. Proc. File No. 3-533, supra, 1969 SEC Lexis 2920 at page 89-90).

(viii) The duty of supervision extends well beyond the branch office.

It has long been held that a broker/dealer cannot rely on a system of supervisory procedures which rely solely on supervision by branch office managers (see in the Matter of Shearson, Hammill & Co., 42 S.E.C. 811, 838-844(1965)). The notion of a chain of command within the supervisory scheme of a broker/dealer is central to a number of administrative decisions which have held broker/dealers liable for poor branch office oversight by regional managers and compliance and legal department personnel. In another often cited decision of the Commission, the duty of supervision was summarized in the leading case of Reynolds and Co., 39 S.E.C. 902 (1960), as follows:

> We have repeatedly held that brokers and dealers are under a duty to supervise the actions of employees and that in large organizations it is especially imperative that the system of internal control be adequate and effective and that those in authority exercise the utmost vigilance whenever even a remote indication of irregularity reaches their attention...

The administrative decisions of the SEC recognize a comprehensive duty of supervision which extends well beyond the branch office level to include regional sales managers, compliance officers and, in certain circumstances, attorneys in the legal departments of brokerage firms.

Many arbitration cases turn upon what obligation, if any, individuals employed in the broker/dealer's compliance or legal departments have with respect to the supervision of trading activity and what affirmative duty, if any, such person will have to intervene when improprieties arise. In the Matter of John H. Gutfreund, Admin. Proc. File No. 3-7930, Securities Exchange Act of 1934, Release No. 34-31554, 1992 SEC Lexis 2939 at page 47 (12/3/92), it was noted that in "...determining if a particular person is a "Supervisor" depends on whether, under the facts and circumstances of a particular case, that person has a requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue" (citing in the Matter of

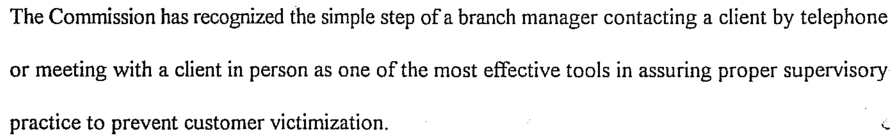
Arthur James Huff, supra, and went on to note that "persons occupying positions in the legal or compliance departments of broker/dealers have been found by the Commission to be "Supervisors" for purposes of Sections 15(b)(4)(E) and 15(b)(6), (citing First Albany Corporation, Supra and Gary W. Chambers, Exchange Act Release No. 27963 (April 30, 1990) and Michael E. Tennenbaum, Exchange Act Release No. 18429 (January 19, 1982)).

(ix) The duty of the branch manager to meet with the customer in person or contact the customer by telephone.

The compliance officer in the Matter of the Application of Bradford John Titus, supra, claimed that he had "insufficient personnel to management 60,000 accounts effectively." The decision went on, however, to cite Stewart K. Patrick, 51 S.E.C. 419, 422 (1993) for the proposition that: ... supervision, by its very nature, cannot be performed by the employee himself", Rita H. Malm, 58 S.E.C. Docket at 130 for the proposition that ". . . we have emphasized that there must be adequate follow-up and review when a firm's own procedures detect irregularities or unusual trading activity" and went on to suggest that the mere expedient of a phone call to the customer by the branch office manager would have served to better afford the firm a better understanding of "the customer's understanding as to suspicious activity in his or her account".

In the Matter of Prudential Securities, Inc., Admin. Proc. File No. 3-8209, Securities Exchange Act of 1934, Release No. 33082, 1993 SEC Lexis 2866 at 65, in faulting branch office manager practices at Prudential Securities, it was suggested that the simple expedient of direct contact between the branch office manager and the customer would be an appropriate supervisory practice to prevent trading improprieties in customer accounts. The decision noted that:

> [i]n implementing the recommended procedures, PSI failed to require branch office managers to review adequately the activity in customer accounts and communicate relative information to customers.



The Commission has recognized the simple step of a branch manager contacting a client by telephone or meeting with a client in person as one of the most effective tools in assuring proper supervisory practice to prevent customer victimization.

(x) Branch managers obligation to detect and prevent abusive cross-selling practices.

Branch managers are responsible for assuring that brokers under their supervision do not engage in any "no net selling" practices, a practice which involves a broker refusing to execute a customer sale order for a particular security until a purchaser has been found. This tactic is known as "cross trading" and is particularly prevalent with Rule 15g-2 "designated securities" or "penny stocks" for which certain broker/dealers serve as a predominate market maker who, in addition, may "dominate and control" trading activity and usually thinly traded, low-priced stock.

In the Matter of C. James Padgett, et al, Admin. Proc. File No. 3-7164 (SEC) Securities Exchange Act of 1934, Release No. 38423, 1997 SEC Lexis 634 (March 20, 1997), supra, pg. 35, it was determined that the four branch managers involved there failed to act with the requisite degree of *scienter*:

> [b]y discouraging agents from executed customer net sell orders and encouraging them to cross orders, they acted, at a minimum, in reckless disregard of the customers interest in prompt execution and sale. In many instances, the branch offices managers knew that orders were being delayed due to their practices or policies. We, therefore, find that Gibs, Sullivan, Sutton and Baird wilfully violated Sec. 17(a) of the Securities Act and Sec. 10(b) of the Exchange Act and Rule 10b-5 thereunder.

This decision affords counsel in arbitration proceedings involving low-priced securities considerable guidance in framing a theory of recovery and also serves to focus the documentation and type of testimony required to best represent the interests of a defrauded investor in low-priced securities cases.

(xi) Duty of branch manager and supervisory personnel to ensure that investors are being provided with rights of accumulation for mutual funds sales commission discount breakpoints

In the Matter of Robert J. Check (Advest, Inc. 8-21409), Admin. Proc. File No. 3-6783, (S.E.C. 1987 Sec Lexis 4322 6/26/87), dealt with a determination that the mutual fund sales manager failed to call to the attention of the compliance department at Advest, Inc. certain mutual fund sales commission breakpoint problems which he was made aware of by way of inquiries from Advest salesmen. In addressing the shortcomings of the mutual funds sales manager, the Commission noted that:

> It appears that Check's review of mutual fund order tickets was self-limited to determining if order ticket information supplied by salesmen was sufficient for him to execute a trade. The absence of information on the ticket regarding ROA (Rights of Accumulation) and LOI (Letters of Intent) did not trigger any inquiry of the salesmen on the possibility of a breakpoint having been reached, although on the immediate sale represented by a ticket under review Check would require a salesmen to recognize the breakpoint if reached in that particular sale. As justification for his inaction in ascertaining whether the salesmen were quoting customers their rights, Check asserted that the salesmen have the responsibility to complete the ticket and that his duty was confined to entering the ticket as a trade unless the ticket had been incorrectly completed.

The Commission disagreed with the mutual funds sales managers contention and determined that he had abdicated his supervisory duties as a mutual funds sales department head (also, see in the Matter of Robert J. Check, Admin. Proc. File No. 3-6783, Securities Exchange Act of 1934, Release No. 26367, 1988 Lexis 2483, (12/16/88)).

(xii) The duty to assure proper supervision of satellite branches and single broker branch offices.

The great bull market of the 1980 and 1990's has seen an unprecedented growth in broker/dealers specializing in one man offices or all satellite offices as distinguished from the conventional branch office with a sizable number of brokers and managerial, administrative and operations personnel. This boom has not been without its compliance problems as the potential for problems, or at least the temptation to engage in questionable activity, may be more pronounced in circumstances where there is no ongoing day to day supervision.

In the Matter of Royal Alliance Associates, Inc., Administrative Proceedings File No. 3-9223, SEC, Securities Exchange Act of 1934 Release no. 38174, 1997 SEC Lexis 113 (1/15/97), the Commission made certain findings relating to supervisory shortcomings in certain branch offices of a broker/dealer having supervisory responsibility for 2,700 registered representatives in approximately 1500 offices supervised by off-site "managing executives". The "managing executive" of the Greensboro, North Carolina office was found to have obtained funds from customers by forging their signatures on third party checks and solicited customers for fictitious CD's, bonds and other securities which were paid for by the customers with checks issued directly payable to the managing executive or his DBA rather than to Royal Alliance, the broker/dealer. The scheme was further complicated by the fact that the managing executive used a pooled account involving converted funds in a bank account in his own name to pay "dividends" or distributions to customers on the fictitious investments. Plus, other illicit activities including churning and the generation of false confirmations to conceal the diversion of funds, as well as fictitious monthly account statements. A similar scheme was perpetrated by a "managing executive" and the broker/dealers' Cocoa Beach, Florida offices.

The decision of the Commission noted that the branch office examination "relied to a large extent on the managing executive's responses to a checklist of questions". The examiners engaged in a review of such key documents as the sales logs, the product cross-index and customer holding pages, 1997 SEC Lexis 113 pages 8-9. In finding these supervisory practices deficient, the Commissioner determined that:

> [T]he examiner failed to detect that the managing executive's sales log, product cross-index and customer holding pages did not reflect variable annuity, limited partnership and mutual funds transactions...[T]he omission of variable annuity, limited partnership and mutual funds transactions from the books and records of the Greensboro office should have raised a red flag, since the managing executive derived most of his commissions by selling those products.

The Commissioner also determined that copies of checks made payable directly to the managing executive or his DBA should have been easily detected. The Commissioner also faulted the broker/dealer for failure to keep a proper log of signature guarantees and the use of the signature guarantee stamp by the "managing executive". The Commissioner went on to find that the broker/dealers "failure to scrutinize adequately the securities-related businesses of its registered representatives which were conducted beyond the direct aegis of the firm, was a certain recipe for trouble", 1997 SEC Lexis 113 at page 14, and faulted the broker/dealer's wholesale failure to have a proper procedure for detailed, surprise inspections of small branch/single registered representative offices, (citing in the Matter of Consolidated Investment Services, Exchange Act Release No. 36-687 (1/5/96)).

CONCLUSION

In the Matter of Hodgdon & Co., Admin. Proc. File No. 3-533, 1969 SEC Lexis 2920 at page 87 (5/15/69), it was noted that:

> [i]t has long been established that the relationship of a securities dealer or a salesman to an uninformed client is one of trust and confidence which approaches and perhaps equals that of a fiduciary...[i]t arises out of the superior sophistication of the dealer, the reposal of special confidence by the customer in the dealer as specially qualified in the securities field and the dealer's acceptance of this reliance...[i]t imposes upon the dealer the responsibility and duty to act in the customer's best interest in effecting transactions in his account (citing Lawrence R. Leehy, 13 S.E.C. 449, 505 (1943); Mason, Moran & Co., 35 S.E.C. 84, 89 (1953); Looper & Co., 38 S.E.C. 294, 300 (1958) and Haley & Company, Inc., 37 S.E.C. 100,106 (1956)).

The administrative decisions of the Securities and Exchange Commission cited in this article should afford the practitioner authority to provide to an Arbitration Panel as to appropriate branch manager supervisory practices which should be taken when "red flags" are raised.

2ND CASE of Level 1 printed in FULL format.

CAPITAL DISTRICT PHYSICIAN'S HEALTH PLAN, Plaintiff, v. MICHAEL O'HIGGINS, d/b/a MICHAEL O'HIGGINS & CO., and DAVID OBERTING, Defendants.

94-CV-61

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF NEW YORK

939 F. Supp. 992; 1996 U.S. Dist. LEXIS 13399; Fed. Sec. L. Rep. (CCH) P99,373

September 11, 1996, Decided

September 11, 1996, FILED

DISPOSITION: [**1] Plaintiff CDPHP's motion for summary judgment upon its second cause of action, upon its claim that defendant O'Higgins breached his fiduciary duty GRANTED. Summary judgment upon the other claims asserted by plaintiff DENIED. Defendants' motions for summary judgment DENIED.

COUNSEL: APPEARANCES:

ROBERT H. ISEMAN, ESQ., ISEMAN, CUNNINGHAM, RIESTER & HYDE, Attorneys for Plaintiff, Albany, NY.

PAUL J. CATONE, ESQ., THORN & GERSHON, Attorneys for Defendant, Albany, NY.

JUDGES: HOWARD G. MUNSON, SENIOR UNITED STATES DISTRICT JUDGE

OPINIONBY: HOWARD G. MUNSON

OPINION: [*995] MEMORANDUM-DECISION AND ORDER

Now comes plaintiff Capital District Physician's Health Plan ("CDPHP") and defendant Michael O'Higgins ("O'Higgins") with cross-motions for summary judgment in a dispute involving a failed investment. Oral argument was heard at this court's motion term in Albany on October 31, 1995. What follows constitutes the court's memorandum-decision and order in this matter.

I. BACKGROUND

This case arises out of an investment management agreement between CDPHP and Michael O'Higgins. Plaintiff CDPHP is a health maintenance organization in the Albany area. Defendant O'Higgins is an investment adviser [**2] operating his own investment management company.

When CDPHP first began accumulating fund surpluses, it invested the excess reserves according to decisions made by members of its own staff. Collins Dep., Doc. 68, at 9. It invested primarily in short term (1-3 month), highly liquid investments in order to keep funds readily accessible for payment of claims. Id. at 11. In 1989, however, in the midst of falling interest rates, CDPHP's Finance Committee ("the Committee") discussed hiring an outside investment manager in order to maximize income while still securing [*996] capital. Id. at 16. After a preliminary search, the Committee selected three firms to give presentations. Id. at 19. Michael O'Higgins & Co. was one of the three firms. In his presentation, he let the Committee know that his investment style could often be described as contrarian; he would invest in securities based on assumptions that went against the prevailing conventional wisdom. Id. at 24-26. The Committee asked O'Higgins to prepare another model portfolio because of the riskiness of some of the investments in the first presentation. As a result, he presented a more conservative portfolio and was selected [**3] to receive half of CDPHP's long term surplus funds for investment. Id. at 39, 81-82. An Investment Management Agreement was signed by the parties on April 19, 1990. Am. Compl., Doc. 29, P 10.

Soon thereafter, in October of 1990, the Committee sent O'Higgins a letter concerning a 30-year bond he had purchased. The bond was not in accordance with the Investment Policy promulgated by CDPHP in 1988. CDPHP Fin. Comm. Mins. ("FCM"), Oct. 19, 1990, at 5. The policy, in pertinent part, required investments (1) to have maturities of at most 10 years, (2) to be a

fixed income security, and (3) to fall within one of seven types of securities (the only applicable category for the present action being "debt instruments of federal government agencies"). Ex. A aff'd to Am. Compl., Doc. 29. O'Higgins was told that his definition of maturity did not comply with that of CDPHP and its investment policy and was instructed to divest CDPHP of the bond as soon as it became advantageous to do so. FCM, Oct. 19, 1990, at 5.

On January 26, 1993, O'Higgins purchased approximately $ 5.1 million in Planned Amortization Certificates-Interest Only ("PAC-IO"). Michael O'Higgins Dep., Doc. 67, at 127. PACs consist [**4] of a group of federally insured mortgages that are pooled together and then divided into different bonds that pay varying ratios of principal and interest. Interest-only PACs yield nearly all of their return (98% in this case) through interest payments. As a result, if mortgage holders decide to refinance (due to falling interest rates, for instance), the security stands to lose a substantial portion of its value. The market for the security is made by investment managers who trade them based on their assessments of the prepayment attrition rate forecasted by investment banks. The PAC-IOs are then bought and sold over the counter pursuant to individual price negotiations between dealers.

In defending his choice of that investment, O'Higgins explained that

I wanted to take a position against the bond market where I would profit from a decline in the bond market.... I mean that if the bond market declined in value, in other words, if interest rates rose, that I would make money, or my client would.

Id. at 127-28.

At the time, the prevailing consensus among most investors was that interest rates would remain stable or continue to decrease. As it turns out, interest [**5] rates did continue to fall. The investment's value declined to $ 4.1 million on February 2, 1993 and $ 3.8 million on March 18. FCM, Mar. 19, 1993, at 4.

CDPHP asked O'Higgins to appear before the Committee at its March 19, 1993 meeting. At that meeting, O'Higgins defended the selection of the PAC-IO investment and also outlined the possible future of the investment. If interest rates stayed low or continued to drop, even more money would be lost; if interest rates rose, interest income would resume and CDPHP could sell the security for a profit; and if market value did not return, interest payments still would continue. O'Higgins considered the first and last predictions unlikely. FCM, Mar. 19 1993, at 4. In answer to O'Higgins statement that he was considering buying more of the PAC-IOs, Diane Bergman, Director of CDPHP, told O'Higgins not to purchase any more of the security until the Committee determined that it was a legal investment for an HMO under New York insurance laws. Id.; Collins Dep., Doc. 68, at 58.

Later that evening, O'Higgins told Tom Collins, a member of the Finance Committee, that he would be resigning, and he did so officially on March 31, 1993. Id. at [**6] 59-60. After hiring First Albany Corporation to take over O'Higgins' CDPHP portfolio, one [*997] half of the PAC-IO was sold August 4 at a loss of $ 1.3 million and the other half was sold on September 1 at a loss of $ 1.1 million. Am. Compl., Doc. 29 PP 58-59. Suit was commenced on January 18, 1994.

Cross-motions for summary judgment have been made on the first and fourth causes of actions, those being the breach of contract and section 10(b)/rule 10b-5 claims, respectively. Defendant O'Higgins has moved for summary judgment on the seventh, eighth, and tenth causes of action, viz. the control person liability, vicarious liability, and negligence claims. Defendant David Oberting, O'Higgins employee and codefendant, has moved for summary judgment on the third and fifth causes of action, the breach of fiduciary duty and section 10(b)/rule 10b-5 violations claims, respectively. In addition, plaintiff has moved for summary judgment on the second and ninth causes of action, i.e. those for breach of fiduciary duty and for Investment Adviser Act violations, respectively. The court is now prepared to rule on these motions.

II. DISCUSSION

A. Standards

The standards for granting [**7] summary judgment pursuant to Fed. R. Civ. P. 56 are governed by a familiar triumvirate of 1986 Supreme Court cases. The movant bears the initial burden of persuading the court that the record demonstrates "the absence of a genuine issue of material fact." *Celotex Corp. v. Catrett, 477 U.S. 317, 323, 91 L. Ed. 2d 265, 106 S. Ct. 2548 (1986).* Genuine issues exist if "there is sufficient evidence favoring the nonmoving party for a jury to return a verdict for that party." *Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249, 91 L. Ed. 2d 202, 106 S. Ct. 2505 (1986).* Once a movant has carried her initial burden, the respondent "must do something more than simply show that there is some metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co. v. Zenith Radio, 475 U.S. 574, 586, 89 L. Ed. 2d 538, 106*

S. Ct. 1348 (1986). In evaluating a summary judgment motion, the court must view the facts in the light most sympathetic to the nonmovant. *Matsushita, 475 U.S. at 587* (quotation omitted). The district judge's inquiry is whether a triable issue exists with respect to the claim being moved upon -- that is, whether there is enough of a material dispute over key facts [**8] that the finder of fact could reasonably decide either way. See *Anderson, 477 U.S. at 250.*

Analysis commences below, beginning with CDPHP's theory under the Investment Advisers Act.

B. Rescission of Contract for Violation of Brochure Rule

The court first turns to a discussion of plaintiff's motion for summary judgment upon its ninth cause of action. See Am. Compl., Doc. 29, P 115-18. Plaintiff argues that it is entitled to rescission of the investment advisory contract and the return of fees paid to defendant O'Higgins because he failed to comply with certain rules promulgated by the Securities and Exchange Commission pursuant to its authority under the Investment Advisers Act of 1940. Pl.'s Mem. Law, Doc. 62, at 46-49.

The Investment Advisers Act, ch. 686, tit. II, 54 Stat. 847 (codified as amended at *15 U.S.C. § 80b-1* et seq.) regulates that profession, imposing registration and disclosure requirements upon advisers, and empowering the SEC to sanction those who violate the Act's provisions. See generally 2 Thomas Lee Hazen, The Law of Securities Regulation ch. 18 (2d ed. 1986). To help effectuate and clarify the Act, the SEC is expressly tasked to develop [**9] rules to supplement it. See, e.g., *15 U.S.C. §§ 80b-3*, 80b-6(4), & 80b-11. The SEC's authority to enforce these rules is concomitant with its authority to police the Act's statutory requirements. Id. § 80b-9.

Plaintiff alleges defendant has failed to comply with one such regulation known as the "brochure rule." 17 C.F.R. § 275.204-3. The brochure rule requires an investment adviser to "furnish each advisory client and prospective advisory client with a written disclosure statement which may be either a copy of Part II of its form ADV . . . or a written document" supplying information [*998] identical to that form. Id. § 275.204-3(a). Form ADV is the initial registration document for investment advisers that must be filed with the SEC. Id. § 275.203-1. Furthermore, "an investment adviser . . . annually shall, without charge, deliver or offer in writing to deliver upon written request to each of its advisory clients" the required information. Id. § 275.204-3(c).

Section 215 of the session law version of the Act, entitled "Validity of Contracts," provides the only remedy available to private plaintiffs. In relevant part, this "voidability" section reads

(b) [**10] Every contract made in violation of any provision of this subchapter and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of any provision of this subchapter, or any rule, regulation, or order thereunder, shall be void . . . .

15 U.S.C. § 80b-15(b) (italics added).

The Supreme Court has held that section 215 authorizes "a suit for rescission or for an injunction against continued operation of the contract, and for restitution." *Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 19, 62 L. Ed. 2d 146, 100 S. Ct. 242 (1979)* (footnote omitted).

No material fact is in dispute with regards to this issue. Defendant concedes that he failed to comply with the brochure rule, in that he did not provide or offer in writing to provide plaintiff with the required information on an annual basis. Michael O'Higgins Dep., Doc. 67, at 194-95. Defendant instead contends that (1) plaintiff's summary judgment motion concerning this omission seeks relief on a claim not set forth in the amended complaint, and (2) that the statute of limitations has run. Defs.' Mem. [**11] Law. in Opp'n, Doc. 64, at 37-41. The court examines these defenses below.

1. Sufficiency of Amended Complaint

Under Fed. R. Civ. P. 8(a) a claim for relief in a complaint, besides alleging grounds for federal jurisdiction, need only set forth "a short and plain statement of the claim showing that the pleader is entitled to relief" and "a demand for judgment for the relief the pleader seeks." Rule 8(e)(1) further instructs the pleader to make his averments "simple, concise, and direct." The Federal Rules of Civil Procedure abandon the arcane and ancient distinctions that encumbered former pleading practice in favor of "notice pleading." See *Conley v. Gibson, 355 U.S. 41, 47-48, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957)*. This theory is liberal to the pleader. A complaint need not state "facts," "ultimate facts," or even "facts sufficient to constitute a cause of action." *Wade v. Johnson Controls, Inc., 693 F.2d 19, 21 (2d Cir. 1982)* (citing 2A James Wm. Moore, Moore's Federal Practice P 8.13 (2d ed. 1995)). All that is required is that a defendant receive fair notice of the nature of the claim and the grounds upon which it rests. *Conley, 355 U.S. at 47.*

Turning to the complaint [**12] in this matter, the relevant paragraphs are

48. The O'Higgins firm failed to provide Securities and Exchange Commission Form ADV, Part II, to CDPHP and failed to disclose the information contained therein.

. . . .

AS AND FOR A NINTH CAUSE OF ACTION

Investment Advisors Act

115. Plaintiff repeats and realleges paragraphs 1 through 114 as if set forth here in full.
116. The O'Higgins firm is an investment advisor within the meaning of *15 U.S.C. § 80b-2*(11).
117. The acts of the O'Higgins firm set forth violated *15 U.S.C. § 80b-6.*
118. CDPHP is entitled to rescission of the investment management agreement to return of the fees paid thereunder, in the amount of $ 142,506.96.

Am. Compl., Doc. 29.

O'Higgins' argument is based on the reference in paragraph 117 to *15 U.S.C. § 80b-6* (section 206 of the session law), the antifraud provision of the Investment Advisers Act. Defendant maintains that the reference [*999] should have been to *15 U.S.C. § 80b-4,* "Reports by investment advisers." This alleged mislabeling, it is argued, failed to give notice to defendant of what kind of claim was being made.

Defendant's construction is inconsistent with the Federal Rules' [**13] theory of pleading. Paragraphs 48 and 116 of the amended complaint sufficiently comprise a factual predicate for a claim for relief. Paragraph 116 avers that defendant is subject to the requirements of the Investment Advisers Act. One of the requirements is the brochure rule. Paragraph 48 alleges that defendant failed to comply with this rule. Paragraph 117 characterizes this omission as a breach of the Act's antifraud provision.

Defendant assumes that the brochure rule was promulgated pursuant to *15 U.S.C. § 80b-4.* That statute obligates those advisers subject to the Act's strictures to "make and disseminate such reports as the Commission, by rule, may prescribe as necessary or appropriate." (italics added) But the antifraud section bestows rulemaking authority as well:

The commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

15 U.S.C. § 80b-6(4) (italics added).

Defendants "are unaware of any case law . . . which holds that a violation of *15 USC § 80b-4* constitutes a violation [**14] of *15 USC § 80b-6.*" Defs.' Mem. Law in Opp'n, Doc. 64, at 37. More properly the question is whether noncompliance with the brochure rule can constitute a breach of § 80b-6, the antifraud provision. It is evident the SEC believed it could be: at the foot of the text of the brochure rule, the Commission cited both session law sections 204 (§ 80b-4) and 206 (§ 80b-6(4)) for statutory authority underpinning the regulation. See 17 C.F.R. § 275.204-3. And the Supreme Court has affirmed generally that simple nondisclosure under the Investment Advisers Act can constitute a fraudulent or deceitful practice. See *SEC v. Capital Gains Research Bureau, 375 U.S. 180, 198-99, 11 L. Ed. 2d 237, 84 S. Ct. 275 (1963).*

Of course, there is no private action under the antifraud provision of the Act. *Transamerica, 444 U.S. at 19-24.* But paragraph 118 of the amended complaint indicates this is not the relief plaintiffs seek. The remedies of rescission of contract and return of fees and other consideration are available under section 215, *15 U.S.C. § 80b-15,* quoted in pertinent part above. *Id. at 18-19.* The claim is reducible to a syllogism: (1) section 215 permits a plaintiff to void [**15] an investment advisory contract, the performance of which involves the violation of the Act or rules promulgated thereunder; (2) defendant herein ignored the brochure rule, violating inter alia the antifraud provision; therefore (3) plaintiff in this case may void the contract and sue for restitution of fees. Cf. *Laird v. Integrated Resources, Inc., 897 F.2d 826, 839 (5th Cir. 1990)* (plaintiff made out sufficient fraud claim under Investment Advisers Act; district court should have granted rescission even though plaintiff did not demand such relief).

Indeed, reading the voidability provision fairly, plaintiff's right to rescind the contract does not turn on whether the brochure rule was issued under the color of section 204 or 206. The fact that plaintiff engaged in an ongoing violation of the brochure rule is sufficient in and of itself. We now proceed to the limitations defense.

2. Statute of Limitations

The limitations period for a cause of action arising under the Investment Advisers Act is one year from the discovery of the wrong, not to exceed three years from commitment of the wrong. *Kahn v. Kohlberg, Kravis, Roberts & Co., 970 F.2d 1030, 1042* (2d Cir.), [**16] cert. denied, *506 U.S. 986, 121 L. Ed. 2d 432, 113*

S. Ct. 494 (1992). Discovery includes not merely actual notice, but constructive or inquiry notice as well. *Menowitz v. Brown, 991 F.2d 36, 41 (2d Cir. 1993)*. The test is an objective one. *Siebert v. Nives, 871 F. Supp. 110, 114 (D. Conn. 1994)*. A plaintiff will be deemed to have discovered the violation when he or she "obtains actual [*1000] knowledge of the facts giving rise to the action or notice of the facts, which in the exercise of reasonable diligence, would have led to actual knowledge." *Kahn, 970 F.2d at 1042* (citation omitted). A plaintiff is on inquiry notice for securities litigation limitation purposes when "storm warnings" appear that would arouse the suspicion of the reasonably prudent investor. E.g., *Siebert, 871 F. Supp. at 114; In re Integrated Resources, Inc., 851 F. Supp. 556, 567 (S.D.N.Y. 1994)*; see *Dodds v. Cigna Secs., Inc., 12 F.3d 346, 350 (2d Cir. 1993)*, cert. denied, *128 L. Ed. 2d 74, 114 S. Ct. 1401 (1994)*.

The relevant dates are not in dispute. Defendant entered into the investment advisory contract with plaintiff on April 19, 1990. The brochure rule requires that the required [**17] disclosure be made prior to or at the entry of the investment advisory contract, and annually thereafter. 17 C.F.R. § 275.204-3(b) & (c). The first complaint was filed January 18, 1994. n1 O'Higgins resigned on March 31, 1993. See Defs.' Mem. Law in Opp'n, Doc. 64, at 40; FCM, May 21, 1993, at 3.

n1 Because the Investment Advisers Act claim was set forth as a cause of action in the original complaint, Doc. 1, PP 115-18, the court rules that for purposes of computation of the limitations period for that claim, the date of filing is January 18, 1994, and not the December 12, 1994 filing date of the amended complaint, Doc. 29.

As an initial matter, it appears clear that no relief may be granted for any wrongs occurring prior to January 18, 1991. Plaintiff has not alleged that any equitable considerations justify tolling the three-year maximum limitations periods, e.g. *Dodds, 12 F.3d at 352-53*, thus the court is bound to apply it. Defendant, however, maintains that his failure to tender the disclosure [**18] prescribed by the brochure rule on each occasion he was required to do so constituted notice sufficient to trip the limitations clock. Defs.' Mem. Law In Opp'n, Doc. 64, at 38. If defendant's argument is accepted, plaintiff will be limited to relief for wrongs occurring on January 18, 1993 and thereafter.

Defendant contends that two facts put plaintiff on constructive or inquiry notice of defendant's noncompliance with the brochure rule: the very omission itself, and that plaintiff's other adviser, Smith Barney, did comply with the rule. Id. at 38-39. Because the court believes the former circumstance constituted notice sufficient to start the limitations period, it does not address the latter argument.

The omission was the fact giving rise to the claim. That plaintiff may not have known at the time that the omission had a legal remedy is of no consequence. Knowledge of the law is presumed and plaintiffs are tasked to exercise reasonable diligence in determining whether or not particular acts or omissions causing injury are actionable in court. See *Keystone Ins. Co. v. Houghton, 863 F.2d 1125, 1127 (3d Cir. 1988); Lee v. United States, 809 F.2d 1406, 1410 (9th Cir. 1987)*, [**19] cert. denied sub nom. *Lee v. Eklutna, Inc., 484 U.S. 1041, 98 L. Ed. 2d 859, 108 S. Ct. 772 (1988)*. The limitations period runs from plaintiff's actual or constructive discovery of the injury, not when he or she first learns that a legal cause of action is available. *Jensen v. Snellings, 636 F. Supp. 1305, 1311 (E.D. La. 1986)*, aff'd in part, rev'd in part on other grounds, *841 F.2d 600 (5th Cir. 1988)*. Similarly, ignorance that the law provides a remedy for a discovered injury cannot be the grounds for equitable tolling. *Jones v. General Motors Corp., 939 F.2d 380, 385 (6th Cir. 1991)*.

Admittedly, the rule seems unduly harsh when applied to circumstances such as these. An omission does not raise a red flag if the victim of the wrong is unaware of the tortfeasor's legal obligation. In this case, that obligation was a relatively obscure one imposed by the Code of Federal Regulations. However, Kahn v. KKR disposes of this line of argument. In that case, plaintiffs sought rescission of an investment advisory contract based upon the defendant's failure to register pursuant to the *Investment Advisers Act. 970 F.2d at 1032*. The Second Circuit ruled that constructive [**20] discovery of the facts sufficient to start the clock occurred when defendant's

> intention not to register under the IAA was made public by a No-Action letter to the SEC reported in an official reporter in [*1001] 1985 and by the fact that such public registration was absent from the public records.

Id. at 1042.

Comparing Kahn to the instant matter, it is difficult to argue that a plaintiff can be charged with knowledge of the publication of SEC no-action letters in the Federal Register, but not with the publication of SEC rules in the Code of Federal Regulations. Defendant's overt failure

to discharge his duty under the brochure rule was the fact giving rise to the claim, and serves as the event tripping the limitations clock.

The Kahn case also stands for the proposition that the "continuing wrong" theory does not apply in an action for rescission based upon an investment adviser's failure to comply with the Act. See *id. at 1039-42.* The Kahn panel rejected the argument that each time the defendant in that case acted as an investment adviser, a new wrong based on defendant's failure to register accrued to plaintiff. *Id. at 1041.* This court similarly rules that [**21] defendant's failure to tender the required information in this case did not transform each subsequent act performed in an investment advisory capacity into a separate wrong, triggering the prescription period anew.

Because plaintiff discovered the facts underlying an action for rescission when defendant failed to comply with the brochure rule as published in the C.F.R, they may only obtain relief for wrongs occurring at most one year prior to filing the original complaint on January 18, 1994. It transpires though that defendant did not violate the brochure rule between January 18, 1993 and January 18, 1994; he resigned as investment adviser for plaintiff before April 19, 1993, the anniversary of the advisory contract. See Defs.' Mem. Law in Opp'n, Doc. 64, at 40; FCM, May 21, 1993, at 3.

The statute of limitations for all violations of the brochure rule in this matter has expired. Plaintiff's motion for summary judgment on the ninth cause of action in its amended complaint is therefore DENIED.

C. Summary Judgment for Breach of Fiduciary Duty

CDPHP also moves for summary judgment based upon an alleged breach of fiduciary duty by defendant Michael O'Higgins', the plaintiff's [**22] second cause of action. Am. Compl., Doc. 29, PP 62-68. In addressing this issue, the court must establish (1) whether a fiduciary relationship was present, (2) whether that relationship entails a duty of disclosure, (3) whether O'Higgins' nondisclosure was material, and (4) what type of causation is necessary to support the award of damages.

1. Presence of a Fiduciary Relationship

Before reaching the issue of whether O'Higgins breached his fiduciary duty to CDPHP, the court must establish whether there was in fact a duty owed. Agent and principal, see, e.g., *Opper v. Hancock, 250 F. Supp. 668* (S.D.N.Y.), aff'd, *367 F.2d 157 (2d Cir. 1966)*, trustee and trust, see, e.g., *Diduck v. Kaszycki & Sons Contractors, Inc., 974 F.2d 270, 275 (2d Cir. 1992)*, and attorney and client, see, e.g., *Milbank, Tweed, Hadley & McCloy v. Boon, 13 F.3d 537 (2d Cir. 1994)* are all relationships that impose the duty of the highest ethical standards on the professional.

The Supreme Court wrote that, in the wake of the stock market crash of 1929, Congress had recognized "the delicate fiduciary nature of an investment advisory relationship" and the need to eliminate [**23] conflicts of interest that could lead to faulty investment advice. *SEC v. Capital Gains Research Bureau, 375 U.S. 180, 191, 11 L. Ed. 2d 237, 84 S. Ct. 275 (1963).* The Court did not question the congressional finding that the investment adviser was a fiduciary; in fact, the Investment Advisers Act reflected the court-imposed duty of "utmost good faith, and full and fair disclosure of all material facts." *Id. at 194* (citation omitted). More recent cases that discuss fiduciary breaches in the investment adviser-client context assume that the fiduciary relationship exists. See, e.g., *Miltland Raleigh-Durham v. Myers, 807 F. Supp. 1025 (S.D.N.Y. 1992); Folger Adam v. PMI Industries, 938 F.2d 1529* (2d Cir.), cert. denied, [*1002] *502 U.S. 983, 116 L. Ed. 2d 612, 112 S. Ct. 587 (1991); Aaron Ferer & Sons Ltd. v. Chase Manhattan Bank, 731 F.2d 112 (2d Cir. 1984).*

In deciding a case based upon New York agency law, the Southern District held that when an investment firm sold 6000 of its own shares of a stock for $ 19.50 while at the same time selling 3000 client-owned shares of the same stock for $ 19.00, it "became liable on bedrock principals that defendant does not [**24] presume to question frontally." *Opper, 250 F. Supp. at 673.* The court ruled that there had been a breach of faith, and that the duties of a fiduciary with respect to an investor were if anything more strict than the duty New York agency law required of other agents. *Id. at 676.*

CDPHP's complaint and Michael O'Higgins' answer agree that the two parties "entered into an 'Investment Management Agreement'" on April 19, 1990. Am. Compl., Doc. 29, P 9; Defs.' Answer, Doc. 30, P 4. There is also agreement that O'Higgins "is in the business of providing investment management services to his clients, including advising clients as to the value of securities and as to the advisability of investing in, purchasing, or selling securities." Am. Compl., Doc. 29, P 6; Defs.' Answer, Doc. 30, P 4. It is not disputed "that defendant Michael O'Higgins did invest funds of the plaintiff in the PAC-IO securities." Defs.' Answer, Doc. 30, P 1. The two parties thus acknowledge the existence of one of the relationships that establishes a fiduciary duty on O'Higgins' part, that of investment adviser and client. During the defendant's deposition, while claiming that he had fulfilled his obligation to [**25] get a good price for the security at issue, O'Higgins

acknowledged that "I'm bound to try to buy securities reasonably for my clients." Michael O'Higgins Dep., Doc. 67, at 391. O'Higgins owed a duty of good faith dealing to CDPHP and knew this duty existed.

As a defense, O'Higgins attempts to distinguish his relationship with CDPHP from typical fiduciary relationships. He argues that because CDPHP's account was discretionary, he had no duty to inform CDPHP of any investment decisions he made before acting upon them. O'Higgins Repl. Mem. Law, Doc. 56, at 14. It is argued that the discretionary nature of the account gave him free rein to act as he wished. The Eastern District of Michigan spoke to the issue of discretionary versus nondiscretionary accounts. *Leib v. Merrill Lynch, Pierce, Fenner & Smith, 461 F. Supp. 951 (1978)*, aff'd, *647 F.2d 165 (6th Cir. 1981)*. In a nondiscretionary account, the customer chooses specific purchases and sales and the investment adviser merely gives effect to those decisions. As a result, any duty ceases when a transaction is complete; the adviser does not, for instance, have to keep abreast of financial information concerning the investment. [**26] *Id. at 953.*

In a discretionary account, on the other hand, the broker or investment adviser is a fiduciary. Id. It is true that the investment adviser does not need prior authorization to make an investment, but the court pointed to four duties that exist specifically in relation to discretionary accounts: (1) to manage the account as the customer stated in authorization papers, (2) to keep informed of market changes, (3) to inform the customers of transactions, and (4) to explain the consequences and risks of any course of dealing in which the adviser engages. Id. The third responsibility refutes O'Higgins' argument about not needing to disclose his trades, but it is the final duty that has even greater relevance. O'Higgins' investment of a large portion of CDPHP's money through his brother is a course of dealing that is neither typical nor to be expected and that did lead to unusual consequences and risks. Since O'Higgins was required to act in the best interests of his client, there was even more reason to disclose a conflict the client could not know about – before the investment was made or at the very least at the meeting when that specific investment was under [**27] scrutiny.

Finally, O'Higgins acknowledges the presence of a fiduciary duty in refuting one of the federal securities law causes of action. "Mr. O'Higgins was still subject to a fiduciary duty of due care, similar to the defendant in O'Brien." O'Higgins Repl. Mem. Law, Doc. 56, at 13 (citation omitted). For these reasons, [*1003] the court holds that O'Higgins owed a fiduciary duty to CDPHP.

2. The Duty To Disclose Conflicts Of Interest

The Supreme Court, in *Chiarella v. United States, 445 U.S. 222, 63 L. Ed. 2d 348, 100 S. Ct. 1108 (1980)*, explained what duties a fiduciary relationship entails. In that case, the Court was applying federal securities law to determine whether a printer trading on inside information about a takeover bid had breached his duty to the plaintiff shareholders. It held that a duty to disclose existed under federal law, but only when the other party was entitled to know that information on the basis of a fiduciary relationship of trust and confidence. *Id. at 228.*

The Second Circuit found a duty to disclose conflicts of interest and other material information in applying New York law to a breach of fiduciary duty claim. The test was nearly identical [**28] to that used by the Supreme Court. "Omissions of material fact may rise to a level constituting fraud and serve as a basis for an action for money damages." *Aaron Ferer & Sons Ltd. v. Chase Manhattan Bank, 731 F.2d 112, 123 (2d Cir. 1984)*. But before that action can lie there must first be a duty of disclosure. That duty to disclose arises if there is a fiduciary relationship established by statute or case law, or if one party possesses superior knowledge, not readily available to the other and knows the other is acting on mistaken information. Id.

In Miltland v. Myers one of the defendant agents had a 25% equity stake in a parcel of land that he was selling. *807 F. Supp. 1025, 1034-35 (S.D.N.Y. 1992)*. The agent's nondisclosure of the possibly adverse interest constituted a breach of fiduciary duty to the principal. *Id. at 1060.* O'Higgins' relationship with his brother is analogous to the 25% equity interest. Although one cannot say decisively that the equity interest or the family relationship led to a fraud or a poor investment, a duty of disclosure exists so that the principal can decide for himself whether the investment adviser can overcome the adverse interest [**29] and live up to the duty of acting in the principal's best interests. The fiduciary's assurances that he can maintain his total objectivity are not enough, even if the court has faith in the fiduciary's character. See *SCA Servs. v. Morgan, 557 F.2d 110, 117 (7th Cir. 1977)*.

In the setting of an attorney-client relationship, the New York Court of Appeals set the ground rules for fiduciaries. *In re Bond & Mortgage Guarantee Co., 303 N.Y. 423, 103 N.E.2d 721 (1952)*. If there is a possibility of a conflict, it is the fiduciary's duty to make a complete disclosure or else stay away from the situation before it becomes a conflict. *303 N.Y. at 431.*

Other states have imposed different standards in re-

quiring a fiduciary to disclose conflicts. Georgia statutes create a duty of disclosure that can be inferred once an agency relationship is established. *McLendon v. Georgia Kaolin Co., 837 F. Supp. 1231, 1240 (M.D. Ga. 1993)* (citation omitted). The Seventh Circuit has held that there exists a duty to disclose even if the plaintiff should have known or could have found out the undisclosed information. *Frey v. Fraser Yachts, 29 F.3d 1153 (7th Cir. 1994).* In the last-mentioned case, [**30] the plaintiff did not have actual knowledge of the conflict of interest (even though the information was available), and even if he did, the defendant had not revealed all the material information. *Id. at 1157.* Consequently, the defendant was liable for receiving commissions from both seller and buyer in a yacht sale. The court cited the Florida Supreme Court in requiring disclosure of all information that bears on the desirability of the transaction. *Id. at 1156-57* (citation omitted). n2

n2 Many circuits also have a test that is used when neither state nor federal law establishes an explicit duty of disclosure (although that duty is established by New York law as has been shown here). It is usually stated as a test of five nonexclusive factors and considers (1) the relationship of the defendant to the plaintiff, (2) the defendant's access to the information compared to the plaintiff's access to that information, (3) the benefit the defendant derives from his relationship with the plaintiff, (4) the defendant's awareness of the plaintiff's reliance, and (5) the defendant's activity in initiating the transaction. See, e.g., *Camp v. Dema, 948 F.2d 455, 460 (8th Cir. 1991); Roberts v. Peat, Marwick, Mitchell & Co., 857 F.2d 646, 653-654 (9th Cir. 1988)*, cert. denied, *493 U.S. 1002, 107 L. Ed. 2d 556, 110 S. Ct. 561 (1989).*

The court is of the opinion that analysis under this approach would still result in a finding that defendant was obliged to disclose the conflict as a matter of law.

[**31]

[*1004] Liability also arose when a broker owned an interest in securities he sold to customers and withheld that fact when recommending the security to a buyer and counseling against selling that particular security to cover a margin call. *Prawer v. Dean Witter, 626 F. Supp. 642 (D. Mass. 1985).* In deciding the case based on Massachusetts common law, the District of Massachusetts held that the broker was liable for failing to disclose an adverse interest. *Id. at 644.* The Fourth Circuit stated a corollary to this holding when it ruled that an agent could have an interest adverse to his principal without breaching his fiduciary duty. *Construction Techniques, Inc. v. Dominske, 928 F.2d 632, 638 (4th Cir. 1991).* But the absolute prohibition against having such adverse interest only disappears when the agent discloses the conflicting interest and the principal consents to the conflict. Id.

The Southern District of Ohio ruled on a similar situation in denying a defendant's motion for summary judgment, but found liability based on a tort theory. *General Acquisition, Inc. v. GenCorp, 766 F. Supp. 1460 (S.D. Ohio 1990).* Fraudulent nondisclosure could result when an agent failed [**32] to disclose a client relationship with a company at the time he was advising his primary client about taking over that company. *Id. at 1475-76.* The agent could be held liable for suppressing a fact that could induce the principal "to establish or continue the relationship." *Id. at 1476.*

This analysis indicates the tension that can occur between the typical case of omission and the omission at bar. Often, the nondisclosure does not exist as a wrong on its own but becomes actionable because of its relationship to other information that was disclosed. An example of this wrong would be giving a client financial records from some prior quarters but not from others because of what those reports indicate when considered in conjunction. But O'Higgins' nondisclosure does not make prior statements misleading or untrue. Instead, the omission is a full and complete harm that creates a false impression of objectivity behind all of O'Higgins' investment decisions.

In Gussin v. Shockey a horse agent was held liable for telling his principal that the horses cost more than the agent paid for them and keeping the difference between the real price and the revealed price. *725 F. Supp. 271 [**33] (D. Md. 1989)*, aff'd, *933 F.2d 1001 (4th Cir. 1991)* As a defense the agent testified that he had bought horses that were undervalued and that the hidden "commission" he received (in addition to his normal fee) only brought the price into line with the horse's real value. *Id. at 274.* In refuting this defense, the District of Maryland wrote that an agent must disclose any personal interest and possible benefit the agent has or might receive even if the transaction is ultimately for the good of the principal. *Id. at 275.* Even if the agent's additional commission did bring the price to the true market value (the negotiated price presumably being low because of the agent's own horse-sense), he had a fiduciary duty to act wholly in the plaintiff's interests and to reveal any divergent interest. Id.

Likewise, O'Higgins can claim that he thought he

was making the best possible investment for CDPHP. Regardless of these intentions, O'Higgins still had a duty to reveal conflicts of interest even if he had a good faith belief that he could overcome that conflict and retain his objectivity in making investment decisions. Even assuming the best intentions on O'Higgins' part, he [**34] is still required to disclose any and all conflicts of interest.

Cases that specifically deal with brother-brother conflicts of interest use a similar analysis. In *SCA Servs. v. Morgan, 557 F.2d 110 (7th Cir. 1977)*, the Seventh Circuit ruled that a district judge had to recuse himself from a case where his brother was a partner in the firm that was representing one of the parties. The Seventh Circuit began from the premise that brothers are close and are inclined to support each other's interests. *Id. [*1005] at 116.* The "appearance of partiality" and public perception concerns that resulted from the relationship led the court to issue a writ of mandamus recusing the judge even though it did not rule that the conflict of interest had affected his conduct in any way. *Id. at 116, 118.*

Another brother-brother conflict of interest occurred in a situation more analogous to the one sub judice. A trustee in a bankruptcy proceeding settled his brother's claim against the bankrupt company before even the secured creditors were paid despite the fact that the brother's claim was seventeen years old and had not been acted upon in that time. *In re Combined Metals Reduction Co., 557 F.2d 179, 196 [**35] (9th Cir. 1977).* The court was not required to rule on whether the settlement reached constituted fraud; it was enough that the trustee had a fiduciary duty to avoid impropriety and the appearance of impropriety. *Id. at 196.* Although the trial court had nothing but praise for the trustee and stressed that in all likelihood he could have kept his objectivity, the Ninth Circuit held that nondisclosure of so patent a conflict of interest was still a breach of duty. *Id. at 197.*

A similar situation occurred in a case involving an accountant's investigation of a company, one of whose officers was his brother-in-law. *In re Colonial Ltd. Partnership, 854 F. Supp. 64 (D. Conn. 1994).* Although ethical rules applicable to accountants were predicated on an assumption of the accountant's independence, that presumption could be and was overcome by the existence of a familial relationship with one of the interested parties. *Id. at 95-96.* A possible conflict of interest clearly could exist because of the presence of the family relationship. The specter of a fiduciary's loss of objectivity carried too much weight to be ignored. Id.

For the foregoing reasons, the court [**36] holds that the defendant had the duty to disclose that the PAC-IO was purchased from his brother.

3. Nondisclosure As a Material Breach

In order for a breach of fiduciary duty based on an omission to be actionable, the nondisclosure must be material. The standard of materiality for omissions has been set by the Supreme Court and followed by both New York State courts and Second Circuit courts.

In deciding a 10b-5 action, the Supreme Court considered the issue of misstatements of material fact. *Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 153-154, 31 L. Ed. 2d 741, 92 S. Ct. 1456 (1972).* In doing so, it established a test for materiality. In order for a fact to be material, it is necessary that a reasonable investor might consider it important in making a decision. Id. The Court again visited the issue of the materiality of nondisclosures in a shareholder derivative suit. *TSC Industries v Northway, Inc., 426 U.S. 438, 48 L. Ed. 2d 757, 96 S. Ct. 2126 (1976).* In deciding whether the object of a takeover bid breached its duty to its shareholders by not releasing information about the negative aspects of the proposal, the Court held that an omitted fact is material if there is a substantial [**37] likelihood that a reasonable investor would consider it important in deciding how to vote. The omission had to satisfy one of two tests: (1) whether there was a substantial likelihood that the omission would have "actual significance in the deliberations of a reasonable investor," or (2) whether there was a substantial likelihood that the omission "significantly altered the 'total mix' of information made available." *Id. at 449.*

The Supreme Court overturned the trial court's grant of summary judgment; in that case, facts had been omitted but they were readily available to the shareholder plaintiffs. *Id. at 452.* Summary judgment only could be granted if the omission was of such obvious importance that the trier of fact could only come to one decision concerning materiality. *Id. at 450.*

The Second Circuit materiality test follows closely the one promulgated by the Supreme Court. In *Folger Adam v. PMI Industries, 938 F.2d 1529* (2d Cir.), cert. denied, *502 U.S. 983, 116 L. Ed. 2d 612, 112 S. Ct. 587 (1991)*, the court subscribed to the "total mix" theory of materiality, stressing that the omission need not be outcome determinative in order [*1006] to be considered material. *Id. at 1533.* In that case, another [**38] incident of a lawsuit in the wake of a takeover bid, PMI and Salomon Brothers did not reveal PMI's correct earnings for the two quarters leading up to the takeover. *Id. at 1531.* See also *Field v. Trump, 850 F.2d 938, 949 (2d Cir. 1988)* (citing TSC v. Northway and using the "total

mix" test).

In terms of the omission having "actual significance in deliberations," CDPHP raises questions that would have been asked of O'Higgins in the heightened scrutiny that would have followed disclosure of the apparent conflict of interest of buying securities from one's brother. For example, CDPHP would have questioned why O'Higgins chose a PAC-IO rather than another interest-sensitive security, why he bought it from First Albany, why he did not study PAC-IO characteristics, and why he did not barter for a better price. Pl.'s Repl. Mem. Law, Doc. 66, at 16. It is clear that a reasonable investor would consider it important that his adviser was purchasing a security from the adviser's sibling. The omission certainly alters the "total mix" of information and would at the very least raise the eyebrows of the investor. A reasonable trier of fact could not label the omission immaterial and this [**39] court will not hold otherwise.

4. Requirement of Proof of Causation For Damages

There is less consensus on the issue of causation of damages in the wake of a fiduciary breach than any of the other elements of the cause of action. Some courts have held that there must be proof of a specific causal connection between the breach and the loss for which the plaintiff seeks to recover. See, e.g., *Havoco of America v. Sumitomo Corp. of America, 971 F.2d 1332 (7th Cir. 1992)* (requiring proof of proximate cause for damages while applying Illinois law); *Naviera Despina, Inc. v. Cooper Shipping Co., 676 F. Supp. 1134 (S.D. Ala. 1987)* (requiring but not finding a proximate causal connection between the breach of fiduciary duty and the loss that resulted). Other courts have imposed similar causation requirements but allowed a wider array of losses once a connection is proved. See, e.g., In re Imperial "400" *Nat., 456 F.2d 926 (3rd Cir. 1972)* (a trustee who violates a duty owes loss in value of the trust resulting from the breach, any profit made through the breach, and any profit which would have been made had there been no breach). Still other circuits place the [**40] burden of proof on the defendant to disprove the causation in the wake of a breach of trust. See, e.g., *Whitfield v. Lindemann, 853 F.2d 1298* (5th Cir.), cert. denied, *490 U.S. 1089, 104 L. Ed. 2d 986, 109 S. Ct. 2428 (1988)* (defendant is not chargeable with loss that would have occurred even if there had been no breach but is responsible for disproving causal connection between breach and loss once the loss is established).

Plaintiffs cite two cases for the proposition that New York law requires a lower standard of damages causation in the wake of a breach of fiduciary duty. The precedent to which plaintiffs and many other courts cite is *Diamond v. Oreamuno, 301 N.Y.S.2d 78, 24 N.Y.2d 494, 248 N.E.2d 910 (N.Y. 1969)*. In that case, directors of a corporation used inside information to sell their shares of corporate stock before the information was released to the public. *301 N.Y.S.2d at 79-80*. The New York Court of Appeals held that the directors had no right to the profit they made from the sale because it was made based on secret knowledge. *Id. at 81*. Although other stockholders had not been injured by the breach of fiduciary duty (it appears from the record that the directors did not own [**41] enough stock to cause a price change when they sold it), there was no need to prove causation in a breach of fiduciary duty claim when an injury was not sustained. Id. The directors had no right to retain profits gained through wrongdoing and the awarding of damages was "not merely to compensate the plaintiff for the wrongs committed by the defendant but ... to prevent them, by removing from agents and trustees all inducement to attempt dealing for their own benefit." Id. (citation omitted).

In the second case, ABCKO Music v. Harrisongs Music, the Southern District of New York held, and the Second Circuit affirmed, [*1007] that "but for" causation was not needed in order to recover damages for a breach of fiduciary duty. *508 F. Supp. 798, 803 (1981)*, aff'd, *722 F.2d 988 (2d Cir. 1983)*. In that case, good faith negotiations were in progress to settle a dispute between ex-Beatle George Harrison and a company who alleged that Harrison had plagiarized a song. *Id. at 802*. Harrison's manager switched sides in the dispute and used his inside knowledge of his former client's record sales in buying the right to sue his former client. Id. Based on his record sales information [**42] (indicating higher sales than the original plaintiff had used in calculating its settlement demand), he offered substantially more money to the original plaintiff than the musician's last settlement offer. Id.

The district court decided the defection of the former manager was to the "probable detriment" of the negotiations based on the circumstances. *Id. at 803*. The court believed that the plaintiff only needed to prove that "good faith negotiations were in progress and ... an eventual settlement was a reasonable possibility." *Id. at 803 n.15*. It did not cite to any cases in selecting that standard of causation. The Second Circuit agreed that proof that the wrong proximately caused the injury was not needed. *ABKCO Music v. Harrisongs Music, 722 F.2d 988, 995-996 (2d Cir. 1983)*. It cited Diamond in concluding that the "district judge is not required to find a 'but for' relationship" between the breach and the harm and that fiduciary duties are prophylactic rules meant to remove the incentive to breach. Id.

The two foregoing cases indicate that New York law requires a loosened standard of causation in breach of fiduciary duty claims, but the circumstances of [**43] those cases are not entirely analogous to the case at bar. The Diamond court did not require proof of damages by the plaintiff because there were no damages to prove, only illicit profits to be recovered. The ABCKO Music court used a diminished standard of proof but did so in a situation where the breach, once discovered, was far more conspicuous and wrong on its face than that of O'Higgins'. Harrison's former manager could not in good faith claim that he was acting in the principal's best interest.

But there are cases that speak more directly to the present circumstances. In the setting of a 10b-5 action, an investment adviser has been found liable for failing to disclose a material fact relating to the investment advice he gave his client. *Chasins v. Smith, Barney & Co., 305 F. Supp. 489 (S.D.N.Y. 1969)*, aff'd, *438 F.2d 1167 (2d Cir. 1970)*. Because the client generally controlled his own account rather than allowing the adviser to have full discretion, the adviser did not need to reveal the resale price of typically traded bonds. *Id. at 495.* But a breach of the adviser's fiduciary duty did occur when he failed to tell the client that he was the market-maker in [**44] a particular security. Id. The district court awarded the plaintiff "the damages resulting from the violations," -- the money he lost on the securities bought through his "reliance" on the broker's omission. *Id. at 496.* In affirming the decision, the Second Circuit explained that the reliance the trial court had found was analogous to a causation in fact inquiry, and either was enough to sustain the award of damages. *438 F.2d at 1172.*

In a recent 10b-5 action, Burke v. Jacoby, the Second Circuit examined the reliance and general causation standards necessary for a securities action, and held that transaction causation (the requirement that the breach be the cause of the securities trade at issue) can be presumed in the case of a material omission. *981 F.2d 1372, 1379 (2d Cir. 1992)*, cert. denied, *508 U.S. 909, 124 L. Ed. 2d 249, 113 S. Ct. 2338*, (1993). If there was a material omission -- that is if a reasonable investor might consider the information that was not supplied important in making the investment decision -- the plaintiff need not positively prove reliance. Id. Transaction causation may be presumed. But the plaintiff still would need to prove causation as to the loss and the trial court [**45] dismissed the action because the plaintiff had offered no evidence that she would have acted differently and avoided the loss had she been given the information. *Id. at 1379-80.* n3 CDPHP, on [*1008] the other hand, has asserted the questions it would have asked had it known of the conflict of interest and indicated that it would have scrutinized the purchase had adequate answers not been supplied. Pl.'s Repl. Mem. Law, Doc. 66, at 16. Contra *Northwestern Nat. Ins. Co. v. Alberts, 769 F. Supp. 498 (S.D.N.Y. 1991)* (court in dicta wrote that the plaintiff had to show transaction causation but not loss causation in order to win damages for a fiduciary breach).

n3 The Fifth and Eighth Circuits are in accord with this assessment of causation. In *Akin v. Q-L Investments, 959 F.2d 521 (5th Cir. 1992)*, the court of appeals held that there was a presumption of reliance in the face of a fiduciary's omission of material fact that was not in effect when there was a positive misrepresentation of material information. However, that presumption was rebuttable if the fiduciary could show that there was not actual reliance and that the investment decision would not have been different had the information been revealed. In *Arthur Young v. Reves, 937 F.2d 1310* (8th Cir.), aff'd, *507 U.S. 170, 117 L. Ed. 2d 407, 112 S. Ct. 1159 (1988)*, the court held that 10b-5 actions require transaction and loss causation but a failure to disclose results in a rebuttable inference of transaction causation.

[**46]

The Second Circuit's decision in Burke is a logical one; it would be difficult for a plaintiff to prove he relied on information that was not given to him. All he could do for proof would be to testify that he would have acted differently had the omission not been made. Having a presumption of transaction causation makes sense once the court decides that the omission was material.

As for loss causation (the requirement that the breach of fiduciary duty must have caused the loss sustained), the Second Circuit dealt extensively with breach of fiduciary duty and its relationship to fraud claims in *Diduck v. Kaszycki, 974 F.2d 270 (1992)*. In an action seeking damages for fraud, there must be (1) a material false representation or omission of existing fact (2) made with knowledge of its falsity (3) with intent to defraud (4) that causes reasonable reliance and (5) damages the plaintiff. Echoing its Chasins affirmance, the court labeled the fourth element congruent to "causation in fact" but wrote that the fraud need not be the exclusive inducing cause. *Id. at 278.* As for fraud damages, the "same causal connection is required between a breach of fiduciary duty and the loss [**47] alleged." *Id. at 279.* In that case, the plaintiff, who had the burden of proof,

failed to establish at trial that the investment funds were "worse off" as a result of the fraud. "Speculative damages cannot support a cause of action for fraud." Id.

More recently, the Second Circuit used a "substantial factor" test to clear up the standard for proof of loss and damage causation. *Milbank, Tweed, Hadley & McCloy v. Boon, 13 F.3d 537, 543 (2d Cir. 1994).* An attorney had breached his fiduciary duty to his client by switching sides in negotiating a transaction. What would have cost his former client $ 8.5 million cost the client $ 10.5 million when the attorney began representing the seller. *Id. at 542.* In awarding $ 2 million in damages, the court held that but for causation was not required; fiduciary duty rules were meant to serve as a prophylactic and not simply to compensate for damages in case of a breach. Fiduciary breaches "in any context" comprise special cases "that often loosen normally stringent requirements of causation and damages." Id.

The problem with the case at bar is that it is difficult to set a baseline to determine proper damages. Even a properly [**48] made investment in a security that clearly fit within the investment plan could have lost money. If O'Higgins wanted to "make a play" on rising interest rates, he could have found an investment through another source and invested in a security within CDPHP's guidelines. A security of this type would have lost money even though it was within the plan as interest rates continued to fall in 1993. There could be no guarantee that the $ 5 million investment would have retained its value in any investment scheme wherein the adviser was banking on a rebound of interest rates. Accepting this hypothetical as likely if the PAC-IOs were not bought, $ 2.4 million seems excessive.

On the other hand, most of CDPHP's O'Higgins' portfolio did perform well and did make money. Even factoring in the PAC-IO loss, O'Higgins' overall investments for CDPHP made a profit overall. Collins Dep., Doc. 68, at 80. The court could determine the average return O'Higgins made on investments [*1009] for CDPHP (with or without the PAC-IO investment factored in) and award damages based on that figure. In that case, damages would be more than $ 2.4 million.

However, both scenarios are completely speculative. It cannot be known [**49] what alternative return or loss the $ 5 million would have made for CDPHP if the PAC-IO investment was rejected: "In the absence of evidence as to the true value of the securities sold to the plaintiff, the proper measure of damages is the loss to the plaintiff upon resale of the securities sold to him." *Chasins, 305 F. Supp. at 496.* In the matter at bar, evidence of what would have transpired had the $ 5 million not been invested in the PAC-IOs is absent. This court will therefore restrict the damages calculation to what did happen, and award damages for the loss that defendant's material nondisclosure was a "substantial factor" in causing. *Milbank, 13 F.3d at 543.*

O'Higgins should not have made the PAC-IO investment without informing CDPHP of the conflict of interest. CDPHP's loss was substantially caused by O'Higgins omission. It could not ask the questions it would have asked. It could not veto the investment before it was made or as soon as it was made because of that omission. Award of the difference between the cost of the investment and its final sale price, minus any interest payments the PAC-IOs made, will return the plaintiff to the position it was in before the [**50] breach of fiduciary duty occurred.

D. Ratification

Defendant O'Higgins seeks summary judgment based on the affirmative defense that CDPHP ratified his investment strategy. Defs.' Not. of Mot., Doc. 42. This could be a successful defense even if the investment in PAC-IOs was unauthorized. *Greenshields Secs., Inc. v. Lau, 819 F. Supp. 1246, 1259 (S.D.N.Y. 1993).* New York law is clear as to the test for ratification. The Second Circuit, interpreting New York law, held that ratification requires (1) the acceptance by the principal of the benefits of the transaction (2) with full knowledge of the facts (3) under circumstances that indicate an intention to adopt the unauthorized agreement. *Monarch Insurance Co. v. Insurance Corp. of Ireland, 835 F.2d 32, 36 (2d Cir. 1987).* See also *Banque Arabe Et Internationale D'Investissement v. Maryland Nat. Bank, 850 F. Supp. 1199, 1213 (S.D.N.Y. 1994),* aff'd, *57 F.3d 146 (2d Cir. 1995); Julien J. Studley v. Gulf Oil Corp., 282 F. Supp. 748, 752 (S.D.N.Y. 1968),* rev'd on other grounds, *407 F.2d 521 (2d Cir. 1969).*

CDPHP could not have had full knowledge of the facts as a result of O'Higgins nondisclosure of his purchase [**51] of the securities through his brother. See *Merex v. Fairchild, 810 F. Supp. 1356 (S.D.N.Y. 1993)* (citing 2 N.Y. Jur 2d Agency §§ 174, 247 for the proposition that the principal must have full knowledge of the agent's act in order to have the ability or duty to ratify or renounce the action), aff'd, *54 F.3d 765* (2d Cir.), cert. denied, *133 L. Ed. 2d 208, 116 S. Ct. 302 (1995).* This court already has established the materiality of the nondisclosure of the brother relationship. As a result, O'Higgins fails to establish the second requirement and his summary judgment motion must fail.

Defendant has argued that Diane Bergman, CDPHP's executive director, did not order O'Higgins to immediately divest CDPHP's investment in the PAC-IO. She

merely told him to buy no more of the security until its legitimacy was cleared with a state insurance authority. O'Higgins Mem. Law, Doc. 43, at 7; FCM, Mar. 19, 1993, at 4. This could indicate an acceptance of the benefits (or in this case, the risks) of the transaction that already had occurred. Doing so during a meeting of the Committee was a circumstance where one would expect an adoption of O'Higgins unauthorized actions to take place. [**52] In addition, O'Higgins argues that Tom Collins, chairman of the Committee, further ratified the transaction after it was made by his positive remarks about the 13% interest the investment was returning despite its riskiness. O'Higgins Mem. Law, Doc. 43, at 7-8.

Tom Collins, director of CDPHP, interpreted the statement differently. He stated that Bergman, despite being director of the [*1010] plan, was not a member of the Committee and did not vote in its deliberations. Collins Aff., Doc. 48, P 8. Telling O'Higgins not to buy more was not a ratification of the prior investment but a prohibition "in no uncertain terms" from making a further investment. Id. P 9. As for Collins' own statement, he characterized it not as ratification but as merely trying to give an accurate picture of CDPHP's options in the wake of the breach. Id. P 4. As a result, material issues of fact remain as to the first and third elements of ratification.

However, even assuming the above arguments satisfy the first and third elements of the defense of ratification, O'Higgins' failure to disclose the circumstances of the PAC-IO's purchase to the Committee negates the second of the three required elements: CDPHP [**53] could not have full knowledge of the facts. All three elements are needed to support a ratification defense. As a result, the statements of Bergman and Collins cannot be the basis of a ratification defense. O'Higgins did not inform CDPHP that he had bought the PAC-IO from his brother, and this nondisclosure of a material circumstance of the transaction precluded CDPHP from having complete knowledge of O'Higgins' actions. When "undisputed facts reveal that there is an absence of sufficient proof as to one essential element of the claim, any factual disputes with respect to other elements of the claim become immaterial." *Burke v. Jacoby, 981 F.2d 1372, 1379 (2d Cir. 1992)*. O'Higgins' motion for summary judgment based on the affirmative defense of ratification must be DENIED.

E. Other Motions for Summary Judgment

In addition to the claims already discussed, there are cross-motions for summary judgment on the first and fourth causes of actions, which are the breach of contract and section 10(b)/rule 10b-5 claims, respectively. Defendant O'Higgins has moved for summary judgment on the seventh, eighth, and tenth causes of action, those being the control person liability, vicarious [**54] liability, and negligence claims. Defendant David Oberting, O'Higgins' employee and codefendant, has moved for summary judgment on the third and fifth causes of action, namely, the breach of fiduciary duty and section 10(b)/rule 10b-5 violations claims.

The court has treated the Investment Advisers Act and fiduciary duty claims thoroughly because no significant facts are disputed with respect to those issues. The same can be said regarding the ratification defense. As for the balance of the pending motions, it suffices to say that material factual discrepancies preclude summary judgment upon those claims. For the most part, all other motions before the court necessarily require resolution of the central factual dispute of whether the PAC-IOs conform to CDPHP's investment policy. The cacophonous discord of the experts convinces this court that this issue cannot be decided before trial.

1. Cross-Motions on Breach of Contract Claim

Although an Investment Management Agreement exists that grants O'Higgins complete discretion in investing on behalf of CDPHP, there is a material dispute as to whether the Investment Policy promulgated by the Committee was part of the original agreement [**55] or was incorporated based on the further actions of the parties. Compare, e.g., Pl.'s Mem. Law in Opp'n, Doc. 52, at 5-6 with O'Higgins Mem. Law, Doc. 43, at 12-15. Moreover, even if the Investment Policy is part of the contract, there is a serious dispute between the experts as to whether O'Higgins complied with the policy's requirements. Compare, e.g., Pl.'s Mem. Law, Doc. 62, at 21-29 with Defs.' Mem. Law in Opp'n, Doc. 64, at 11-17. As such, the cross-motions for summary judgment based upon breach of contract must be DENIED.

2. Cross-Motions on Section 10(b) and Rule 10b-5 Claims against O'Higgins

As for the antifraud causes of action, plaintiff admits that it must prove scienter as one of the elements of that cause of action, but argues that the record contains no issues of material fact. Pl.'s Mem. Law, Doc. 62, at 39. Scienter need not rise to the total intent required to establish fraud. *Ades v. Deloitte & Touche, 799 F. Supp. 1493, 1498-99 [*1011] (S.D.N.Y. 1992)*. Yet even the lesser standard of "intent to defraud, knowledge of the falsity, or a reckless disregard for the truth," id., has not been established for the purpose of a summary judgment [**56] motion. Compare, e.g., Defs.'

Mem. Law in Opp'n, Doc. 64, at 28-30 with Pl.'s Repl. Mem. Law, Doc. 66, at 13-14. The experts of each party have clashed repeatedly as to whether the PAC-IO was a government security, whether it was a fixed or variable-income security, and whether its maturity was greater than 10 years. Compare, e.g., Pl.'s Mem. Law, Doc. 62, at 21-29 with Defs.' Mem. Law in Opp'n, Doc. 64, at 11-17. As a result, the motion for summary judgment based on section 10(b) and rule 10b-5 must be DENIED.

3. O'Higgins Motion on Negligence Claim

Defendant O'Higgins has argued that CDPHP cannot maintain a breach of contract and negligence claim concurrently. O'Higgins Mem. Law, Doc. 43, at 15-17. While it is true that New York law requires a duty distinct from that created by the contract, see, e.g., *RKB Enterprises, Inc. v. Ernst & Young, 182 A.D.2d 971, 972, 582 N.Y.S.2d 814 (N.Y. App. Div. 1992),* plaintiff has in fact alleged that O'Higgins negligently breached a distinct duty in his management of the investment fund. Plaintiff has argued that the role of an investment adviser creates an independent duty analogous to that of lawyer and [**57] client. Am. Compl., Doc. 29, P 120; Pl.'s Mem. Law in Opp'n, Doc 52, at 33-24. The argument is not enough to establish the negligence claim without more substantive proof at trial, but it is enough to preclude summary judgment for the defendant on the claim. As a result, defendant's motion for summary judgment on the negligence claim is DENIED.

4. Oberting Motion on Breach of Fiduciary Duty Claim

Plaintiff and defendant assert wildly divergent roles for David Oberting in the events surrounding the PAC-IO purchase. Plaintiff alleges that Oberting admitted to serving as CDPHP's stockbroker and that he was an integral part of the sale of the PAC-IO because of the information he provided to CDPHP concerning the security. Pl.'s Mem. Law in Opp'n, Doc. 52, at 29. Defendant, on the other hand, portrays Oberting as a mere conduit for the investment decisions made by O'Higgins. Oberting exercised no discretion with regards to the purchase, and his provision of information about the security after it was purchased was immaterial since CDPHP could not rely on the information after the purchase had been made. Oberting Mem. Law, Doc. 45, at 7-8. Clearly, issues of fact remain as to the third [**58] cause of action. The defendant's motion for summary judgment with respect to the fiduciary duty claim against Oberting must therefore be DENIED.

5. Oberting Motion on Section 10(b) and Rule 10b-5 Claim

The same scienter requirement exists with respect to the fifth cause of action as with the cross-motions by CDPHP and O'Higgins with respect to the fourth cause of action. Once again, CDPHP asserts that Oberting was a key figure in the PAC-IO purchase and knew as much, while Oberting claims his conduct was meant to aid CDPHP and evidenced no wrongful intent. Compare, e.g., Oberting Mem. Law, Doc. 45, at 11-13 with Pl.'s Mem. Law in Opp'n, Doc. 52, at 31-32. Summary judgment for defendant Oberting on the fifth cause of action concerning those same federal security law violations must therefore be DENIED.

6. O'Higgins Motions on Control Person Liability and Vicarious Liability Claims

Material issues of fact remain as to defendant Oberting's liability. The court cannot determine O'Higgins' motion for summary judgment on the control person liability and vicarious liability claims until it determines Oberting's liability. As a result both motions for summary judgment [**59] must be DENIED.

III. CONCLUSION

The court GRANTS plaintiff CDPHP's motion for summary judgment upon its second cause of action, that is, upon its claim [*1012] that defendant O'Higgins breached his fiduciary duty. Summary judgment upon the other claims asserted by plaintiff is DENIED. Defendants' motions for summary judgment are also DENIED.

The parties are directed to prepare for trial.

It is So Ordered.

Dated: September 11, 1996

Syracuse, New York

HOWARD G. MUNSON

SENIOR UNITED STATES DISTRICT JUDGE

1ST CASE of Level 1 printed in FULL format.

CAPITAL DISTRICT PHYSICIAN'S HEALTH PLAN, Plaintiff, v. MICHAEL O'HIGGINS, d/b/a MICHAEL O'HIGGINS & CO., and DAVID OBERTING, Defendants.

94-CV-61

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF NEW YORK

951 F. Supp. 352; 1997 U.S. Dist. LEXIS 367

January 16, 1997, Decided

January 16, 1997, FILED

DISPOSITION: [*1] Defendant Michael O'Higgins' motion for reconsideration DENIED. Plaintiff CDPHP's motion for a preliminary injunction DENIED. Plaintiff's motion for Rule 54(b) certification of this court's prior grant of summary judgment upon the second cause of action in the amended complaint -- the claim that O'Higgins breached his fiduciary duty to CDPHP -- GRANTED. Judgment entered in favor of plaintiff CDPHP and against defendant Michael O'Higgins in the amount of $ 2,677,645.45.

COUNSEL: APPEARANCES:

ROBERT H. ISEMAN, ESQ., MICHAEL J. McNEIL, ESQ., ISEMAN, CUNNINGHAM, RIESTER & HYDE, Attorneys for Plaintiff, Albany, New York.

ARTHUR H. THORN, ESQ., PAUL J. CATONE, ESQ., THORN & GERSHON, Attorneys for Defendants, Albany, New York.

JUDGES: HOWARD G. MUNSON, SENIOR UNITED STATES DISTRICT JUDGE

OPINIONBY: HOWARD G. MUNSON

OPINION: MEMORANDUM-DECISION AND ORDER

In the wake of this court's prior decision granting plaintiff Capital District Physician's Health Plan ("CDPHP") partial summary judgment against defendant Michael O'Higgins, both parties have filed additional motions. The plaintiff, a health maintenance organization in the Albany area, moves to certify the partial judgment for immediate [*2] appeal pursuant to Federal Rule of Civil Procedure 54(b), and for a preliminary injunction precluding defendant from encumbering or alienating assets against which a judgment may be satisfied. Defendant, a registered investment adviser, moves for reconsideration of the summary judgment order pursuant to Local Rule 7.1(g). All the motions are opposed. The following opinion constitutes the court's disposition of these matters.

I. BACKGROUND

For an exposition of the procedural history and facts of this case the reader is referred to this court's prior opinion granting partial summary judgment, number 72 on the docket and reported at *939 F. Supp. 992 (N.D.N.Y. 1996)*. Briefly, defendant served as investment adviser for CDPHP, at one time responsible for half its portfolio. Defendant purchased a security known as a PAC-IO from his brother for CDPHP's account. The investment soon turned sour. Plaintiff brought suit. After discovery the parties filed cross-motions for summary judgment. The court granted the motion with respect to one of plaintiff's causes of action, viz. the claim that defendant breached his fiduciary duty to plaintiff by purchasing the PAC-IO from his brother [*3] without disclosing the conflict. The court also found that defendant's proffered affirmative defense of ratification was insufficient as a matter of law to defeat summary judgment on the fiduciary duty claim. Additionally, the court held that CDPHP's claim based on the Investment Advisers Act of 1940, i.e. the "brochure rule" claim, was barred by the statute of limitations. All other claims were infused with material factual discrepancies requiring trial.

Evidently concerned that defendant was secreting or transferring assets against which a final judgment eventually could be satisfied, plaintiff moved for equitable relief to preserve those assets and for Rule 54(b) certification so that execution of judgment could proceed without

awaiting the resolution of all other claims. Defendant objected to the injunction and certification and timely moved for reconsideration of the summary judgment order. Discussion follows, beginning with defendant's motion.

II. DISCUSSION

A. Reconsideration

A motion for reconsideration, other than one under Rule 60, is governed by this district's Local Rule 7.1(g) which requires a memorandum "concisely setting forth the matters or controlling [*4] decisions which the movant believes the court has overlooked." This court has previously identified three grounds for reconsideration: (1) an intervening change of controlling law, (2) the emergence of new evidence which bears upon the issues decided, and (3) the necessity to correct clear error or to prevent a manifest injustice. *Frutiger v. Hamilton Central Sch. Dist., 1993 U.S. Dist. LEXIS 12610,* No. 90-CV-303, 1993 WL 358480, at *1 (N.D.N.Y. Sept. 9, 1993), appeal dismissed, *28 F.3d 102 (2d Cir. 1994)* (table). Although Frutiger was decided under former Local Rule 10(m), the law is the same under the current rule, and all the judges in this district are in agreement. See, e.g., *Louis J. v. General Motors Corp., 940 F. Supp. 47, 49 (N.D.N.Y. 1996)* (Pooler, J.); *Certain Underwriters at Lloyd's, London v. St. Joe Minerals Corp., 889 F. Supp. 65, 66 (N.D.N.Y. 1995)* (McAvoy, C.J.), aff'd, *90 F.3d 671 (2d Cir. 1996);* Agway, Inc. v. Travelers Indem. Co., No. 93-CV-557, 1991 WL 642767, at *1 (N.D.N.Y. Jan. 24, 1994) (Cholakis, J.); *Palaimo v. Lutz, 837 F. Supp. 55, 55 (N.D.N.Y. 1993)* (Scullin, J.); *Fox v. Board of Trustees, 148 F.R.D. 474, 477 (N.D.N.Y. 1993)* (McCurn, Sr. J.), [*5] aff'd, *42 F.3d 135 (2d Cir. 1994),* cert. denied, *132 L. Ed. 2d 873, 115 S. Ct. 2634 (1995).*

Defendant O'Higgins asks the court to reconsider three points: (1) whether causation of damages was proved as a matter of law; (2) whether the measure of damages was appropriate, and (3) whether the appropriate date for the calculation of damages was used. Def.'s Mem. Law, Doc. 80, at 1. Additionally, defendant's opposition to plaintiff's motion for certification was accompanied by two new affidavits suggesting there is a sounder factual predicate for the ratification defense than the court originally thought. See Exs. C & D att'd to Def.'s Aff., Doc. 86. The court treats this as a fourth asserted ground for reconsideration.

1. Causation

Taking the issues seriatim, the court observes first that the question of causation was not neglected in this court's prior decision: pages 33 to 42 of the slip opinion, Doc. 72, dealt extensively with the issue. Motions for reconsideration are not opportunities to relitigate competently decided issues and should not be considered a last chance to sway the court. *Libutti v. United States, 910 F. Supp. 67, 70 (N.D.N.Y. 1995).* A mere point [*6] of disagreement between the court and a litigant is not a basis for reconsideration. *Rivera v. Prudential Ins. Co., 1996 U.S. Dist. LEXIS 16337,* Nos. 95-CV-0829 & 95-CV-0830, 1996 WL 637555, at *16 (N.D.N.Y. Oct. 21, 1996).

For instance, defendant argues that he had unlimited discretion to purchase securities for CDPHP's account pursuant to the investment advisory agreement, including the authority to buy from his blood brother. Doc. 80 at 3-5. Therefore, the argument goes, defendant's purchase of the PAC-IOs could not have caused the loss, since CDPHP was not owed the duty of disclosure and could not have vetoed the investment. This court was fully aware of this argument when deciding the cross-motions for summary judgment and rejected it. This court held that notwithstanding the discretionary nature of the CDPHP account, defendant could not escape the obligation to disclose this particular conflict of interest. See Mem.-Dec. & Ord., Doc. 72, at 22-23 (citing *Leib v. Merrill Lynch, Pierce, Fenner & Smith, 461 F. Supp. 951 (E.D. Mich. 1978),* aff'd, *647 F.2d 165 (6th Cir. 1981)* (table)). Furthermore, the argument that CDPHP could not have prevented O'Higgins from buying any security he wished for [*7] CDPHP's account is specious. Such authority is a necessary incident of the agency relationship, of CDPHP's power to terminate O'Higgins as investment adviser, and is correlative with O'Higgins' duty to disclose conflicts of interest. See 3 N.Y. Jur. 2d Agency § 189 (agent's duty to obey instructions).

As a second objection to this court's causation analysis, defendant contends that the failure to disclose the conflict was not a substantial factor causing CDPHP's loss because the record fails "to establish that the purchase would not have been made if the omitted information had been disclosed." Def.'s Mem. Law, Doc. 80, at 6. In support, defendant cites *Burke v. Jacoby, 981 F.2d 1372 (2d Cir. 1992),* cert. denied, *508 U.S. 909, 124 L. Ed. 2d 249, 113 S. Ct. 2338 (1993),* a securities fraud case wherein the Second Circuit held that when a material omission is involved, transaction causation may be presumed but loss causation must be proven. Again, this court's prior opinion considered Burke carefully, Doc. 72, at 38-39, and ruled that the omission was a substantial factor contributing to the loss. This issue is not novel, and defendant has identified no new controlling [*8] precedent nor flushed out any manifest error justifying reconsideration.

In his third attack upon causation, defendant avers that the damages were too speculative to prove that the omission caused the loss. Doc. 80 at 8. This issue has already been fully briefed, professionally argued, and deliberately decided. The omission was material and was a substantial contributor to the loss CDPHP suffered on the PAC-IOs bought from defendant's brother. Without the information, CDPHP could not intelligently question or veto the investment. Defendant is referred to the summary judgment opinion for further explanation.

Since defendant has raised no matters the court has overlooked or pointed to any manifest or obvious error in the court's disposition of the causation issue, defendant's motion for reconsideration upon this ground is denied.

2. Measure of Damages

Defendant maintains that the calculations of damages made in the summary judgment order was erroneous. Doc. 80 at 10. In that opinion, the court observed that

evidence of what would have transpired had the $ 5 million not been invested in the PAC-IOs is absent. This court will therefore restrict the damages calculation to [*9] what did happen, and award damages for the loss that defendant's material nondisclosure was a "substantial factor" in causing.

Doc. 72 at 42 (citation omitted).

The court consequently held that the loss occasioned by defendant's breach of fiduciary duty was "the difference between the cost of the investment and its final sale price, minus any interest payments the PAC-IOs made." Id. That amount is $ 1,863,553.05. n1

n1 CDPHP also seeks prejudgment interest at the New York statutory rate of 9 percent. See Pl.'s Mem. Law, Doc. 74, at 8.

Defendant suggests that this court misapplied the case of *Chasins v. Smith, Barney & Co., 305 F. Supp. 489 (S.D.N.Y. 1969)*, aff'd, *438 F.2d 1167 (2d Cir. 1970)*, in deciding how to measure damages caused by the breach. Specifically, O'Higgins points out that the defendant in Chasins was the market-maker for the securities he bought on behalf of the plaintiff. *Id. at 495-96.* In those circumstances, it was impossible to tell what the price of the [*10] securities should have been, because the defendant essentially set the price. Without any way of determining fair market value of those securities, the Southern District awarded plaintiff the loss upon resale, as this court has done in the instant matter. *Id. at 496.*

In this case there is no allegation that defendant or his brother were the market-makers in the PAC-IOs. But this is of no moment. Defendant has overlooked the Second Circuit's mandate in the Chasins case. The defendant in that dispute made a similar argument on appeal as O'Higgins makes here:

Smith, Barney's final challenge is to the amount of damages awarded to Chasins, claiming that only the difference between the price charged him on his purchases and the fair market value on the purchase dates could be granted; we disagree. . . . Although Smith, Barney submitted an affidavit on the issue of damages, indicating that the price Chasins paid for his purchases was the same as that generally available from other dealers for the same securities, that is not the question here. The issue is not whether Smith, Barney was actually manipulating the price on Chasins or whether he paid a fair price, but rather the [*11] possible effect of disclosure of Smith, Barney's market-making role on Chasins' decision to purchase at all on Smith, Barney's recommendation. It is the latter inducement to purchase by Smith, Barney without disclosure of its interest that is the basis of this violation; the evil in such a case is that recommendations to clients will be based upon the best interests of the dealer rather than the client.

438 F.2d at 1173.

The Court of Appeals then ruled that the difference between original purchase and resale price is an appropriate measure when "the evil is not the price" plaintiff pays, but rather the failure to disclose the adverse interest. Id. Comparison with the matter sub judice is apt. The issue here is not whether O'Higgins obtained a fair price from his brother for the PAC-IOs bought for CDPHP's account, but rather defendant's failure to disclose the conflict to his client. The court declines to revisit the issue of damage calculation.

3. Date From Which Damages Are Measured

O'Higgins argues that damages should be measured from March 19, 1993 -- the date he met with CDPHP's finance committee to discuss the PAC-IO investment -- rather than from January [*12] 26, 1993, the date of the original purchase. Def.'s Mem. Law, Doc. 80, at 11. In those two months, the investment declined about $ 1.3 million in value. O'Higgins argument in this regard rests on this passage from the partial summary judgment order:

Since O'Higgins was required to act in the best interests of his client, there was even more reason to disclose a

conflict the client could not know about -- before the investment was made or at the very least at the meeting when that specific investment was under scrutiny.

Doc. 72 at 23 (italics added for emphasis).

Defendant pins his hopes on the last clause, reasoning that the omission giving rise to the breach did not occur until he failed to disclose the conflict at the March 19 meeting with CDPHP's finance committee during which the PAC-IO investment was discussed.

This is more weight than these words can bear. The breach of fiduciary duty occurred when the purchase was made from defendant's brother. In its prior order the court was merely expressing surprise that defendant did not disclose the conflict even when he was haled before the finance committee and interrogated specifically about the PAC-IO transaction. [*13] Disclosure at that time, however, would not have excused the initial purchase from his brother. Only intelligent ratification by CDPHP of the transaction could have accomplished that on March 19. No ground for reconsideration is implicated here.

4. Ratification

In its prior order this court determined that defendant's proffered ratification defense was no barrier to granting summary judgment on the breach of fiduciary duty claim. O'Higgins' failure to disclose that the PAC-IOs had been purchased from his brother meant that CDPHP could not have had full knowledge of the underlying facts, one of the requirements for a successful ratification defense. See *Monarch Ins. Co. v. Insurance Corp. of Ireland, 835 F.2d 32, 36 (2d Cir. 1987).*

By the close of discovery and after the summary judgment motions had been submitted, the undisputed facts established this timeline relevant to ratification. The PAC-IOs were purchased by defendant on January 26, 1993. Michael O'Higgins Dep. Tr., Doc. 67, at 127. At that time, CDPHP's finance committee met monthly. Every two months, CDPHP's director of finance prepared an investment report summarizing the performance of the plan's investment advisers. [*14] The finance committee would review the reports every other month, and vote to approve or disapprove investment decisions made in the previous two months by the plan's advisers. The board of directors also met every two months to approve or disapprove investment decisions previously reviewed by the finance committee. Thomas P. Collins Dep. Tr., Doc. 68, at 40-42. Between the purchase of the PAC-IOs on January 26 and the March 19 meeting, CDPHP became aware of and curious about the investment. Mary Connolly, CDPHP's director of finance, telephoned Thomas P. Collins, a CDPHP board member and chairman of the finance committee, sometime in March to express concern about the security. *Id. at 53-54.* Collins instructed Connolly to find out more about the investment. Ellen Pierce, CDPHP's controller, and Tim Rock, a senior accountant, made inquiries in early March. Michael O'Higgins was out of the country at that time and his employee and codefendant David Oberting responded on his behalf. On March 5, 1993 Oberting sent a one-page facsimile transmission addressed to Tim Rock and Ellen Pierce relating to the PAC-IOs. Ex. C att'd to Defs.' Notice of Mot., Doc. 42. On that same date, he sent [*15] a letter to Mr. Rock with other information. Ex. D att'd to id. That letter appears to have been copied nearly verbatim from a handwritten fax from James O'Higgins, the broker, to Oberting. Ex. B att'd to Culnan Aff., Doc. 46. Tim Rock received another fax from Oberting on March 8. Ex. G att'd to Defs.' Notice of Mot., Doc. 42. Ellen Pierce received additional faxes from Oberting on March 9, Ex. E att'd to id., and March 18, the day before the finance committee meeting, Ex. F att'd to id. These transmissions all purported to describe some characteristic of the PAC-IOs, and appear to be in response to queries submitted by Ellen Pierce and Tim Rock. O'Higgins appeared before CDPHP's finance committee on March 19, 1993 to explain the transaction. On that same night O'Higgins informed the finance committee chair that he would be resigning, and did so officially on March 31, 1993. *Id. at 59-60.* CDPHP searched for another investment adviser to manage the funds previously under defendant's control. In May of 1993 First Albany Corporation took over the O'Higgins portfolio and advised CDPHP on how to dispose of the PAC-IO investment. May 21, 1993 Fin. Comm. Mins. at 5.

Because [*16] at no point did it appear that defendant disclosed to CDPHP the role of his brother in the PAC-IO transaction, this court has ruled that plaintiff could not have had the full knowledge requisite to effective ratification. Doc. 72 at 43. In opposition to CDPHP's motion for certification however, O'Higgins has tendered two affidavits, one from defendant's brother and another from codefendant David Oberting. Oberting's affidavit describes a conversation he had with a CDPHP employee "some time before the March 19th meeting and after CDPHP had received its February statement." Ex. C att'd to Doc. 86, at 1. Oberting reports that he referred the caller, who was asking about the PAC-IO purchase, to James O'Higgins. Oberting concludes that "CDPHP was aware of the fact that James O'Higgins had acted as the broker for this investment." Id. at 2. James O'Higgins' affidavit confirms that he was called "in advance of [the March 19th] meeting" and he spoke

to either Mary Connolly or Ellen Pierce of CDPHP. Ex. D att'd to Doc. 86, at 1-2. James O'Higgins states that "CDPHP was aware of the fact that I had been the broker for my brother with respect to this investment." Id. P 5. Although these [*17] affidavits were submitted in opposition to CDPHP's motion for Rule 54(b) certification, it is clear they are also relevant to Michael O'Higgins' motion for reconsideration. If the affidavits are taken as support for the proposition that CDPHP knew that defendant bought the PAC-IOs from his own brother, this court's prior decision holding that CDPHP's ignorance of this material information precluded effective ratification is undermined.

Plaintiff has objected by letter that the affidavits are improper new evidence. It is true that new evidence submitted on reconsideration must have been unavailable previously through the exercise of due diligence. *United States v. Potamkin Cadillac Corp., 697 F.2d 491, 493* (2d Cir.) (new evidence in Rule 60 motion) (quoted case omitted), cert. denied, *462 U.S. 1144, 77 L. Ed. 2d 1379, 103 S. Ct. 3128 (1983).* As both Oberting and James O'Higgins were deposed, it cannot be disputed that this information was available to defendant and could have been easily elicited for the record. Moreover, it is beyond peradventure that CDPHP's knowledge, or lack thereof, of the conflict of interest was an important and apparent issue to both parties at all [*18] relevant times during discovery. As this court has observed, its opinions "are not intended as mere first drafts, subject to revision and reconsideration at a litigant's pleasure." *Frutiger v. Hamilton Cent. Sch. Dist., 1993 U.S. Dist. LEXIS 12610,* No. 90-CV-303, 1993 WL 358480, at *1 (N.D.N.Y. Sept. 9, 1993) (quoting *Quaker Alloy Casting Co. v. Gulfco Indus., 123 F.R.D. 282, 288 (N.D. Ill. 1988)),* appeal dismissed, *28 F.3d 102 (2d Cir. 1994)* (table). When parties submit cross-motions for summary judgment after extensive discovery involving many hundreds of pages of deposition transcripts, affidavits, and documentary evidence, this court invests significant energy to decide them. Understand then the court's frustration when evidence contradicting what appears to be an uncontested factual predicate is not brought to the court's attention until after an order issues. To remedy this waste of judicial resources, the rule has developed that evidence which is not truly new -- that is, it was known at the time of the original motion, or should have been known -- will not be weighed on a motion for reconsideration. E.g., *Atlantic States Legal Found. v. Karg Bros., 841 F. Supp. 51, 56-57 (N.D.N.Y. [*19] 1993).*

Defendant counters that the affidavits do not contain new allegations or evidence, but that the prior depositions of James O'Higgins and codefendant David Oberting reflected that CDPHP had prior knowledge of the conflict of interest. Specifically, defendant refers us to pages 153 and 154 of James O'Higgins' deposition transcript. However, nowhere on those pages is there even the vaguest suggestion that James O'Higgins, or anyone else, informed CDPHP about the conflict of interest before the March 19 meeting. There was some questioning about James' knowledge that CDPHP was Michael's client:

Q. Did there come a point in time, in 1993, when you became aware that your brother's client was the Capital District Physician's Health Plan which had purchased this security?
A. [James O'Higgins] In 1993? I don't recall.
Q. Did there come a time, at any time, when you became aware that the Capital District Physician's Health Plan was the client that had purchased this security?
A. Yes.
Q. When was that?
A. I don't remember.

Ex. 1 att'd to Doc. 68, at 153-54.

But these answers do not imply that CDPHP may have known that James O'Higgins, the broker for the PAC-IO [*20] transaction, was the brother of Michael O'Higgins, the investment adviser, before March 19, 1993. Even if this passage had been flagged to the court at the original summary judgment motion, rather than on reconsideration, it would have been insufficient to create a material issue of fact concerning CDPHP's knowledge.

As for David Oberting, defendant does not refer to any deposition testimony or other evidence before the court prior to the summary judgment order which suggested CDPHP may have become aware of the conflict before the March 19 meeting. Nonetheless, the court has again reviewed Mr. Oberting's deposition transcript, and particularly pages 54 and sequential wherein there is questioning concerning Oberting's contacts with CDPHP. It appears that Oberting sent a letter to Tim Rock at CDPHP that contained information about the PAC-IOs obtained from James O'Higgins. Ex. 2 att'd to Doc. 68, at 71-73. However that letter does not identify James O'Higgins as the source of the information. Ex. A att'd to Culnan Aff., Doc. 46. Oberting admitted as much. Ex. 2 att'd to Doc. 68, at 78. Nothing in the deposition transcript of David Oberting suggests CDPHP learned of the conflict in time [*21] to ratify the purchase.

Needless to say, ratification is an affirmative defense for which defendant carries the burden of proof. E.g., *Banque Arabe Et Internationale D'Investissement v. Maryland Nat'l Bank, 850 F. Supp. 1199, 1213*

(S.D.N.Y. 1994), aff'd, *57 F.3d 146 (2d Cir. 1995)*. On motions for summary judgment wherein the plaintiff has demonstrated that no material issues of fact remain for trial on one of his claims, defendant must do more than merely aver the existence of a valid affirmative defense to defeat the motion; he must come forward with evidence showing that there are sufficient factual questions regarding that defense that a trial is needed. See *Matsushita Elec. Indus. Co. v. Zenith Radio, 475 U.S. 574, 586, 89 L. Ed. 2d 538, 106 S. Ct. 1348 (1986)* ("opponent must do more than simply show that there is some metaphysical doubt as to the material facts"). Defendant O'Higgins could not keep the affidavits currently at issue as hole cards; he was obligated to play them to demonstrate that genuine issues of material fact surrounded the proferred ratification defense, requiring that CDPHP's fiduciary duty theory be relegated to trial. If the movant has carried [*22] his burden under Rule 56 and there is no triable issue of fact with regards to any affirmative defense, summary adjudication is appropriate. See generally 6 James Wm. Moore, Moore's Federal Practice § 56.17[4] (2d ed. 1996).

The information in the affidavits was available to defendant prior to the summary judgment order and should have been disclosed then. Nothing in the discovery materials reflects the facts in the affidavits, thus the court did not overlook any controlling matters. Even if the court were to consider these affidavits though, they do not squarely refute the relevant proposition. In order to create genuine issues of material fact concerning the ratification defense, the Oberting and James O'Higgins affidavits must tend to show that CDPHP knew that their investment adviser bought PAC-IOs from his own brother. This they do not do.

David Oberting affirms that before the March 19 meeting he referred an officer or staff person from CDPHP to James O'Higgins for further information regarding the PAC-IO transaction. Ex. C att'd to Doc. 86, P 3. Therefore, he concludes, "CDPHP was aware of the fact that James O'Higgins had acted as the broker for this investment during [*23] the course of this telephone conversation." Id. P 5. This affidavit supports the contention that CDPHP knew that James O'Higgins was the broker for the PAC-IO transaction. It does not state that CDPHP knew that James O'Higgins was the brother of Michael O'Higgins.

The affidavit of James O'Higgins is similarly canny. He avers that

there is no question that during that discussion that the person that I spoke with as a representative of CDPHP was aware of the fact that I had been the broker for my brother with respect to this investment.

Ex. D att'd to Doc. 86, P 5.

They may have been aware that James was Michael's broker, but did they know that James was Michael's brother? This affidavit slyly avoids stating that proposition. That their last names are identical is a frail reed for defendant to lean upon. These affidavits, coy as they are and coming before the court only now, when plaintiffs are moving to certify the partial summary judgment, raise troubling issues of veracity. n2 Even if the court were to consider these affidavits despite that they clearly should have been submitted prior to summary judgment, in these circumstances they are insufficient to create [*24] a genuine issue of fact precluding judgment upon CDPHP's breach of fiduciary duty claim.

n2 Several facts cast doubt on these affidavits. First, neither of the affiants is hostile towards defendant O'Higgins. Oberting is or was his employee and James O'Higgins is his brother. These relations suggest that defendant was not prevented from learning of the alleged pre-March 19 telephone conversation between CDPHP and James O'Higgins until now, but instead probably knew of it before this court's prior opinion. Second, the minutes of the March 19, 1993 meeting of CDPHP's finance committee make no mention of the conflict of interest, despite the fact the PAC-IO transaction is a central topic of discussion. Fin. Comm. Mins., Mar. 19, 1993, at 4. Third, the contemporaneous notes of Ellen Pierce, then CDPHP's controller, do not reveal any knowledge of the conflict. Ex. A att'd to Pierce Aff., Doc. 49. The transcript she later typed up from these notes also fails to mention that the broker and the investment adviser were brothers. Ex B att'd to id. Given CDPHP's obvious interest and concern over the PAC-IO investment, and the apparently unusual step of asking Mr. O'Higgins to attend the meeting to explain the security, it seems unlikely that the fraternal relationship would not have come up had CDPHP learned of it before March 19.

[*25]

Now arguendo, let us assume that the affidavits are properly submitted at this time and that they create an issue of fact regarding whether or not CDPHP had full knowledge of the PAC-IO transaction. Does that then create a triable issue concerning ratification? Ratification has three conjunctive elements: (1) acceptance by the principal of the benefits of the transaction (2) with full knowledge of the relevant facts (3) under

circumstances indicating an intention to adopt the unauthorized acts. *Monarch Ins. Co. v. Insurance Corp. Of Ireland, 835 F.2d 32, 36 (2d Cir. 1987).* Although this court's prior order disposed of the ratification defense based upon CDPHP's ignorance of the conflict, its discussion of the other two elements cast doubt upon whether there was any intent to ratify or acceptance of the benefits. See Mem.-Dec. & Ord., Doc. 72, at 44-45. Nevertheless, after summarizing the arguments, this court concluded that factual issues existed in regards to the first and third elements, *id. at 45,* and proceeded to decide the matter on the second element, knowledge. The reconsideration motion compels a reexamination of the circumstances surrounding the transaction, [*26] and whether any colorable argument for ratification is made out.

"Ratification may be express, as by spoken or written words, or it may be implied from any act, words, or course of conduct on the part of the principal which reasonably tend to show an intention to ratify" the unauthorized or illegal act. 2 N.Y. Jur. 2d Agency § 168 (1979). Ratification can occur by silence. *Merex A.G. v. Fairchild Weston Sys., 810 F. Supp. 1356, 1370 (S.D.N.Y. 1993),* aff'd, *29 F.3d 821 (2d Cir. 1994),* cert. denied, *130 L. Ed. 2d 639, 115 S. Ct. 737 (1995).* Or more precisely, the principal's intent to ratify may be "implied from knowledge of the principal coupled with a failure to timely repudiate." *Julien J. Studley, Inc. v. Gulf Oil Corp., 282 F. Supp. 748, 752 (S.D.N.Y. 1968),* rev'd on other grounds, *407 F.2d 521 (2d Cir. 1969).* Repudiation must be within a reasonable time after the principal learns all the facts, and the actual interval depends on the circumstances of the case. 2 N.Y. Jur. 2d Agency § 175 (1979). But ratification is not lightly or easily established. The intent "must be clearly established and will not be inferred from doubtful or equivocal acts or language." [*27] 57 N.Y. Jur. 2d Estoppel, Ratification, and Waiver § 76, at 109 (1986); accord *Holm v. C.M.P. Sheet Metal, Inc., 89 A.D.2d 229, 233, 455 N.Y.S.2d 429, 432 (N.Y. App. Div. 1982).* Bearing these principles in mind, the court proceeds to revisit the circumstances surrounding the contact between CDPHP and O'Higgins following the PAC-IO investment.

Again, the PAC-IOs were bought January 26, 1993. CDPHP became aware of the investment when they received a purchase confirmation slip from the broker, First Albany Corporation, sometime in February. See Collins Dep. Tr., Doc. 68, at 43; Ex. H att'd to Iseman Aff., Doc. 61 (confirmation slip); Connolly Dep. Tr. at 10-11 (finance director became aware of purchase in mid-February upon receipt of "buy slip"). Then followed a flurry of phone calls, facsimiles, and letters in early March whereby CDPHP asked questions about the PAC-IOs, as detailed supra. Nothing in that correspondence in the least manifests any intention to ratify the transaction. Indeed, it would be more reasonable to assume that the number of inquiries indicated concern about the PAC-IOs.

Defendant O'Higgins argued in his own summary judgment motion that a statement made [*28] by Diane E. Bergman, CDPHP's executive director, at the March 19 meeting of the finance committee established his ratification defense. Defs.' Sum. J. Mem. Law, Doc. 43, at 6-7. According to the committee minutes, "Ms. Bergman informed Mr. O'Higgins that no additional purchases of this type of investment should be made until the Plan receives notification from the Insurance Department that this is an acceptable, admitted asset." Ellen Pierce's handwritten and typewritten notes of this meeting agree that this was the substance of Diane Bergman's statement. Exs. A & B att'd to Pierce Aff., Doc. 49. Others who attended the committee meeting are in accord. See Collins Aff., Doc. 48; Bergman Aff., Doc. 50; Conners Aff., Doc. 51. And the deposition of Thomas Collins reported the statement similarly. See Collins Dep. Tr., Doc. 68, at 58-59.

O'Higgins argues that Bergman's admonition not to buy more until the PAC-IO was cleared with the state insurance department was an implicit approval of the securities already purchased. Defs.' Sum. J. Mem. Law, Doc. 43, at 7. The court disagrees. Even if it appeared CDPHP's concerns were not aroused prior to that statement, Bergman's injunction [*29] not to buy more hardly seems to be an endorsement of what was already bought. When the circumstances are taken into account, as they must be, see *Monarch Ins., 835 F.2d at 36,* it becomes even more obvious that no ratification occurred by dint of this statement. O'Higgins was before the committee to explain a suspect investment. CDPHP had already directed a number of questions to David Oberting prior to the meeting. Considering the surrounding facts, it seems patent that CDPHP was not ratifying an investment with full knowledge of the facts surrounding its purchase, but was rather collecting information on an investment about which it entertained serious doubts. At the very least, the statement is equivocal and dubious, thus precluding a finding of ratification. See *Holm, 455 N.Y.S.2d at 432.*

Defendant also relies on the March 29, 1993 Board of Directors meeting to support his ratification defense. Defs.' Sum. J. Mem. Law, Doc. 43, at 7-8. Michael O'Higgins was not present at this meeting -- indeed, he had made his intention to resign known the night of the 19th. His absence does not per se preclude a finding of ratification based upon what transpired at the

board meeting however. [*30] Ratification is concerned with the actual intent of the party against whom it is pled. The related doctrine of estoppel, by contrast, is concerned with what has been expressed to the party pleading that defense. See generally 57 N.Y. Jur. 2d Estoppel, Ratification, and Waiver § 76 (1986) (comparing ratification and estoppel). But to return to the point, the discussion at the board meeting as reflected in the minutes and Tom Collins' deposition and affidavit do not show any ratification of the PAC-IO transaction. The minutes from the directors' March 29, 1993 meeting contain these passages which defendant finds significant:

Ms. Connolly stated that Michael O'Higgins had a beginning account value in January of $ 19.2 million. Unfortunately, one of the securities that was purchased lost approximately $ 1.0 million. We transferred $ 1 million into the account. The market value at the end of February was $ 19.3 million. We were concerned about this investment and had Mr. O'Higgins speak at the Finance Committee Meeting to address that concern.

Mr. Collins stated that O'Higgins invested in interest-only securities which are high risk. He was banking on interest rates going back [*31] up, mainly because of the Clinton economics. The timing to buy these was premature, and was too risky to suit the Finance Committee. However, these interest only accounts are still paying us 13% return on our investment. We plan to hold onto these investments until the interest rates go up.

Ex. H att'd to Defs.' Notice of Mot., Doc. 42.

Defendant points primarily to the last two sentences, but reading them in the context of the above quote yields a more accurate interpretation. O'Higgins contends that CDPHP's intent to hold onto the securities until the rates go up indicates an acceptance of the benefit of the 13% return rate. But it is clear that Connolly and Collins are merely making a factual report to the Board about what had transpired in regards to the PAC-IO so far. Moreover the "benefit" of interest payments must be considered in light of the million dollar loss in value the investment had already suffered. Indeed, the May 24 meeting of the Board makes it even more evident that CDPHP was merely hoping to recoup their investment. See Ex. J att'd to id. In Collins' words, "this information was given to the Board in an attempt to make the best decision we [*32] could concerning a very difficult situation." Collins Aff., Doc. 48, at 2. No unequivocal act of ratification occurred here.

O'Higgins informed Collins he intended to resign the night of March 19, and the resignation was effective the March 31. Collins Dep. Tr., Doc. 68, at 59-61. CDPHP began searching for another adviser to take over the account previously managed by O'Higgins. Id. at 62. First Albany was selected in May. May 24, 1993 Board of Directors Mins., Ex. J att'd to Defs.' Notice of Mot., Doc. 42, at 2. At the advice of First Albany, one-half of the PAC-IOs were sold in August 1993 and the other half in September. Collins Aff., Doc. 48, at 2.

No ratification can be implied from the delay in disposing of the PAC-IO investment. CDPHP acted with reasonable diligence in finding an adviser to take over the portfolio left unmanaged by O'Higgins' abrupt resignation. See *Nye v. Blyth Eastman Dillon & Co., 588 F.2d 1189, 1198 (8th Cir. 1978)* (investment owner permitted reasonable time to enable him "to consult counsel, employ another broker and to analyze the market"). After being retained, First Albany promptly produced a report concerning the PAC-IOs in which they recommended [*33] that half be sold immediately. July 19, 1993 Fin. Comm. Mins. It appeared that CDPHP was wary of merely dumping the entire investment when it appeared that interest rates might rebound -- there was concern that immediately selling the whole investment could be held a failure to mitigate damages. See id. Instead, CDPHP chose to follow the advice of their new investment adviser and dispose of the PAC-IOs in a more orderly, deliberate fashion. Reasonable planning, investigation, and deliberation following discovery of an unauthorized act for the purpose of putting affairs in order will not constitute ratification by silence or by acceptance of benefits. See, e.g., *Bingham v. Zolt, 823 F. Supp. 1126, 1132 (S.D.N.Y. 1993)* (plaintiff estate did not ratify unauthorized acts of legal and financial advisers when instead of disaffirming tax structure, estate took steps to minimize additional losses), aff'd, *66 F.3d 553 (2d Cir. 1995)*, cert. denied, *134 L. Ed. 2d 543, 116 S. Ct. 1418 (1996)*; *Bernstein v. Centaur Ins. Co., 644 F. Supp. 1361, 1370 (S.D.N.Y. 1986)* (three month silence after learning of unauthorized acts during which plaintiff undertook investigation was not ratification). [*34]

Finally, the court would be remiss not to point out the most obvious indication that no unequivocal ratification of the PAC-IO transaction was made by CDPHP: defendant Michael O'Higgins admitted none was made. Specifically, he gave the following answers to questions from CDPHP:

Q. Since the time that the PAC-IO investment was purchased for CDPHP, has any representative of CDPHP said to you, in words or substance, that your purchase of the PAC-IO investment was acceptable to CDPHP?

. . . .

A. No.
Q. Has any representative of CDPHP said to you that in their opinion your purchase of the PAC-IO investment was within the bounds of the investment policy?
A. No.
Q. Has any representative of CDPHP indicated to you that they agreed with your decision to purchase the PAC-IO security?
A. No.

O'Higgins Dep. Tr., Doc. 67, at 384-85.

Needless to say, this is substantial evidence that no ratification was intended or occurred.

Under New York law, acts as equivocal as the ones defendant O'Higgins proffers as ratifying gestures do not present factual issues meriting a trial. See *Chelsea Nat'l Bank v. Lincoln Plaza Towers Assocs., 61 N.Y.2d 817, 819, 462 N.E.2d 130, 131, [*35] 473 N.Y.S.2d 953, 954 (N.Y. 1984).* Thus even assuming the new affidavits of Oberting and James O'Higgins are admissible, credible, and relevant -- assumptions that are challenging to support -- the ratification defense is insufficient to bar the prior grant of partial summary judgment in favor of plaintiff. The motion for reconsideration is denied. The court proceeds to CDPHP's cross-motion to certify the partial judgment for immediate appeal.

B. Rule 54(b) Certification

This court granted summary judgment in favor of plaintiff only upon the second cause of action in the amended complaint, Doc. 29 -- the fiduciary breach claim. All other claims against defendant O'Higgins and all the claims against defendant Oberting were infused with material factual issues warranting a trial. Plaintiff moves to certify that partial summary adjudication.

Civil Procedure Rule 54(b) provides that

> when more than one claim for relief is presented in an action . . . or when multiple parties are involved, the court may direct the entry of a final judgment as to one or more but fewer than all of the claims or parties only upon an express determination that there is no just reason for delay [*36] and upon an express direction for the entry of judgment.

Absent such determination and direction partial summary judgment is merely an interlocutory adjudication "subject to revision at any time before the entry of judgment" deciding the whole suit.

The Second Circuit has set forth three steps for making the certification decision: (1) the action must have multiple claims or parties, (2) at least one claim must have been finally decided within the meaning of *28 U.S.C. § 1291*, and (3) there must be no just reason for delay. See *Ginett v. Computer Task Group, Inc., 962 F.2d 1085, 1091 (2d Cir. 1992).* The first two factors of the inquiry are jurisdictional and are reviewed de novo on appeal. *Id. at 1091-92.* As for the third factor, whether there is any just cause for delay is a matter of the district court's discretion and is reviewed only for abuse. See *Curtiss-Wright Corp. v. General Elec. Co., 446 U.S. 1, 8, 64 L. Ed. 2d 1, 100 S. Ct. 1460 (1980).* A party may seek certification by way of motion practice. 6 James Wm. Moore, Moore's Federal Practice P 54.41[3], at 54-218 (2d ed. 1996). Once the certification is made, the partial adjudication is appealable, and [*37] the judgment may be executed upon. Routine invocation of the rule is disfavored. *Cullen v. Margiotta, 811 F.2d 698, 710* (2d Cir.), cert. denied sub nom. *Nassau County Republican Comm. v. Cullen, 483 U.S. 1021, 97 L. Ed. 2d 764, 107 S. Ct. 3266 (1987).* The Second Circuit requires strict compliance with Rule 54(b). E.g., *International Controls Corp. v. Vesco, 535 F.2d 742, 747 (2d Cir. 1976)*, cert. denied, *434 U.S. 1014, 54 L. Ed. 2d 758, 98 S. Ct. 730 (1978).* Not only must the Rule 54(b) determination and direction be expressly recited, an explanation must be given for the court's decision to make the certification. *Harriscom Svenska AB v. Harris Corp., 947 F.2d 627, 629-30 (2d Cir. 1991); In re Chateaugay Corp., 928 F.2d 63, 64 (2d Cir. 1991)* (per curiam).

Turning to the first factor, it is obvious multiple parties are involved -- there are two individual defendants named in the suit and subject to different causes of action. This is sufficient for this Rule 54(b) prerequisite, and there is no necessity to proceed to the question of whether multiple claims for relief are involved. 10 Wright, Miller & Kane, Federal Practice and Procedure: Civil 2d § 2656, [*38] at 48-49 (1983). The question of multiple claims is relevant to the wisdom of certifying the partial summary judgment for immediate appeal however, and the court will move on to address that question.

Whether there are multiple claims depends on how we define the phrase "claim for relief" in the rule. As Professor Wright has observed, "there is no generally accepted test that is used to determine whether more than one claim for relief is before the court." 10 Wright § 2657, at 61. The occasional case in this circuit suggests all that is needed is a multiplicity of numbered legal causes of action in the complaint. See, e.g., *Ginett, 962 F.2d at 1092.* This approach is attractive because it concentrates substantive Rule 54(b) analysis in the discretionary third factor, leaving to the first two jurisdictional inquiries only the ministerial task of counting

defendants, plaintiffs, and causes in the complaint. See generally 6 Moore P54.33[2], at 152-53 (language in Sears v. Mackey supports this interpretation).

Whatever the merits of that process, less ambiguous cases have treated the claim multiplicity question as requiring inspection of the factual relatedness of the [*39] different theories of recovery:

In *Gottesman v. General Motors Corp., 401 F.2d 510, 512 (2d Cir. 1968)*, we defined the word "claim" in the context of Rule 54(b) as "the aggregate of operative facts which give rise to a right enforceable in the courts." (quoting *Original Ballet Russe v. Ballet Theatre, 133 F.2d 187, 189 (2d Cir. 1943))*.

Hudson River Sloop Clearwater v. Dep't of Navy, 891 F.2d 414, 418 (2d Cir. 1989).

The Gottesman decision also quoted *McNellis v. Merchants Nat'l Bank & Trust Co. Of Syracuse, 385 F.2d 916 (2d Cir. 1967)* for the above definition. Judge Port, formerly of this district, had certified a partial summary judgment for immediate appeal in McNellis. *Id. at 918*. The Second Circuit dismissed the appeal, holding that "although the complaint stated two 'causes of action,' there was but one 'claim for relief' under the federal rules." Id. See also *State of New York v. AMRO Realty Corp., 936 F.2d 1420, 1424 (2d Cir. 1991)* (court "must examine . . . the relationship between plaintiffs' claims to determine whether they are sufficiently separate and distinct as to lend themselves to review as single units, or whether [*40] they are so interrelated and dependent upon each other as to be one indivisible whole.").

This court is of the opinion that the fiduciary duty claim is sufficiently separable from plaintiff's contract, securities fraud, and other theories that it is an individual claim for relief within Rule 54(b)'s meaning. The aggregate of facts required to prove the fiduciary breach cause are different than those required to prove breach of contract, for example. As this court observed in its summary judgment order, Doc. 72 at 47, victory on the contract claim requires a finding that CDPHP's investment policy was incorporated into the investment management agreement. The factfinder also must answer the question of whether the PAC-IO conformed to the investment policy. Neither of these inquiries is necessary to the finding that O'Higgins breached his fiduciary duty to CDPHP. As for plaintiff's antifraud theories, both Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 require proof of scienter. Id. at 47-48. But bad intent is not a predicate to a fiduciary breach in this case: "Even assuming the best intentions on O'Higgins' part, he is still required to disclose any and all [*41] conflicts of interest." Id. at 29. The court is satisfied that the claim CDPHP seeks to certify is separate and distinct from those questions remaining for trial. See *Hudson River Sloop Clearwater, 891 F.2d at 418*.

We briefly touch on defendant's objections to the claim multiplicity issue. O'Higgins cites several out-of-circuit cases for the proposition that "claims cannot be separate unless separate recovery is possible on each." Def.'s Mem. Law, Doc. 85 at 3 (citing *Local P-171, Amalgamated Meat Cutters v. Thompson Farms Co., 642 F.2d 1065, 1070-71 (7th Cir. 1981))*. Assuming the truth of that assertion, defendant apparently is overlooking plaintiff's demand for investment advisory fees, which are not an element of the damages for the fiduciary breach. They might be recoverable if CDPHP was successful on its contract claim however. Moreover, codefendant Oberting is a joint and several tortfeasor on several causes of action; if the fiduciary breach summary judgment proves uncollectable against O'Higgins, then CDPHP could attempt to execute against Oberting, if the health plan is successful on the fiduciary duty or securities law claims lodged against the codefendant. In [*42] any event, it is clear that the damages attributable to O'Higgins' breach of fiduciary duty are not the only ones potentially recoverable by plaintiff in this matter.

The second requirement for Rule 54(b) certification is that the certified claim must be finally decided within the meaning of *28 U.S.C. § 1291*. Final decisions are those that "end[] the litigation on the merits and leave[] nothing for the court to do but execute the judgment." *Coopers & Lybrand v. Livesay, 437 U.S. 463, 467, 57 L. Ed. 2d 351, 98 S. Ct. 2454 (1978)* (quoted case omitted). Defendant objects that the issue of prejudgment interest, requested by the plaintiff for the first time in its motion for certification, has not been decided thus precluding entry of judgment. The point is valid and is addressed below.

The third factor -- whether there is no just cause for delay -- is decided by the district court's balancing of "judicial administrative interests as well as the equities involved." *Curtiss-Wright Corp. v. General Elec. Co., 446 U.S. 1, 8, 64 L. Ed. 2d 1, 100 S. Ct. 1460 (1980)*. This court's role is one of a "dispatcher," determining when the appropriate time for letting a final decision proceed [*43] to execution or appeal has come. *Sears, Roebuck & Co. v. Mackey, 351 U.S. 427, 435, 100 L. Ed. 1297, 76 S. Ct. 895 (1956)*. Having performed the analysis, the court has found several equities and administrative concerns that warrant the certification.

Plaintiff now has a substantial judgment in its favor, and failure to certify could result in profound delay in the

receipt of relief. The same concern supported the Rule 54(b) certification in the *Curtiss-Wright case. 446 U.S. at 11.* Moreover, if this court's grant of summary judgment is sustained on appeal, trial may be avoided altogether. The damages attributable to the fiduciary breach, without prejudgment interest, are approximately $ 1.86 million. The other damages CDPHP seeks in its complaint -- the investment advisory fees -- amount to about $ 120,000. While this amount is not insubstantial by any measure, trial on the remaining claims may be expensive due to the necessity of expert financial testimony, and an out-of-court resolution of the fees consequently may be facilitated if plaintiffs can recover the damages for the breach of fiduciary duty. Judicial economy would thus be served.

If the remaining issues do ultimately [*44] proceed to trial, sound judicial administration is still advanced. If CDPHP is successful on the appeal of a certified summary judgment, then the trial may be much simplified and shortened. Many witnesses pertinent to the issue of ratification may not be called. The court will be left primarily with the issues of the interpretation of the investment advisory agreement and the investment policy and the classification of the PAC-IO security. Testimony would not be muddied with the question of "who knew what when."

Plaintiff has also proffered as a sound reason for certification the fact that defendant O'Higgins has moved to Florida. CDPHP is concerned that with the passage of time the judgment will become increasingly uncollectable, due in part to Florida's generous debtor protection laws. In support of this argument, plaintiff cites a Seventh Circuit case wherein a Rule 54(b) certification was upheld based on the district court's determination that the defendant's "precarious financial position" might jeopardize collection. *Bank of Lincolnwood v. Federal Leasing, Inc., 622 F.2d 944, 949 (7th Cir. 1980); id. at 951.* Although the court does not wish to overstate the case, it [*45] is true that O'Higgins' relocation to Florida may make execution more difficult. Further delay can only exacerbate the problem.

In sum, the equities and administrative considerations counsel for expedition of the appeal. The fiduciary duty question is distinct from the other claims asserted by plaintiff, and its early resolution will contribute to the efficient disposition of the entire case. The court consequently holds that there is no just reason to delay the entry of final judgment on the fiduciary duty claim. Because this court is granting the Rule 54(b) certification and the judgment will be subject to execution in accordance with applicable procedural rules, the motion for injunctive relief to preclude the alienation of assets against which the judgment may be satisfied is denied. All that is left is the question of prejudgment interest.

C. Prejudgment Interest

In this court's prior opinion granting partial summary judgment, the formula for computation of the damages attributable to O'Higgins' breach of fiduciary duty was described as "the difference between the cost of the investment and its final sale price, minus any interest payments the PAC-IOs made." Doc. 72 [*46] at 42. There appears to be no dispute that the damages principal amounts to $ 1,863,553.05. Connolly Aff., Doc. 76. Plaintiff however also seeks simple interest at the New York statutory rate of 9 percent. That figure is accruing at the rate of $ 459.51 a day, and through the last day of 1996 totalled $ 806,740.24.

Even in a suit premised on federal question jurisdiction, the decision whether to award prejudgment interest on pendent state law claims is governed by state law. E.g., *Strobl v. New York Mercantile Exch., 590 F. Supp. 875, 881 (S.D.N.Y. 1984)* (MacMahon, J.), aff'd, *768 F.2d 22* (2d Cir.), cert. denied sub nom. *Simplot v. Strobl, 474 U.S. 1006, 88 L. Ed. 2d 459, 106 S. Ct. 527 (1985).* On this issue, New York law provides that

> interest shall be recoverable upon a sum awarded because of a breach of performance of a contract, or because of an act or omission depriving or otherwise interfering with title to, or possession or enjoyment of, property, except that in an action of an equitable nature, interest and the rate and date from which it shall be computed shall be at the court's discretion.

N.Y.C.P.L.R. 5001(a) (McKinney Supp. 1997).

Thus [*47] in contrast to federal law which leaves all questions of prejudgment interest to the court's discretion, New York law mandates the award when the action lies at law. *Hilord Chem. Corp. v. Ricoh Elecs., Inc., 875 F.2d 32, 39 (2d Cir. 1989).* The consensus of federal courts interpreting New York law is that actions for breach of fiduciary duty fall in the category for which prejudgment interest is a matter of right. In one case from the Southern District of New York, the defendant Citibank was acting as an investment adviser and fiduciary agent to a plaintiff named Gajria. *Quintel Corp. v. Citibank, 606 F. Supp. 898 (S.D.N.Y. 1985).* Gajria obtained a jury verdict against Citibank for breach of fiduciary duty. Judge Sweet held that Gajria was entitled to prejudgment interest on this claim. *Id. at 914.* He also concluded that such interest had to be calculated at the New York statutory rate. *Id. at 915* (applying N.Y.C.P.L.R. 5004). As another court has noted

The proposition that prejudgment interest is customarily awarded to compensate a plaintiff for damages due to the loss of the use of money in cases involving breach of fiduciary duty does indeed find ample precedent. [*48]

McCoy v. Goldberg, 810 F. Supp. 539, 546 (S.D.N.Y. 1993).

See also cases cited at id.; *Spector v. Mermelstein, 485 F.2d 474, 482 n.8 (2d Cir. 1973)* (suggesting fiduciary duty claims seeking damages as relief are classified as actions at law for which prejudgment interest is mandated).

The statutory rate is nine percent. N.Y.C.P.L.R. 5004. Simple interest, rather than compound, is the rule. E.g., *Long Playing Sessions, Inc. V. Deluxe Labs., Inc., 129 A.D.2d 539, 540, 514 N.Y.S.2d 737, 738 (N.Y. App. Div. 1987).* As for when interest runs from, section 5001(b) governs that consideration:

Interest shall be computed from the earliest ascertainable date the cause of action existed, except that interest upon damages incurred thereafter shall be computed from the date incurred. Where such damages were incurred at various times, interest shall be computed upon each item from the date it was incurred or upon all of the damages from a single reasonable intermediate date.

CDPHP has included with their Rule 54(b) memorandum a loss computation chart that meets the requirements of this section, current through September 18, 1996 (the computation [*49] is appended to this opinion). Prejudgment interest will therefore be awarded as calculated therein, with an additional $ 459.51 per day between September 18, 1996 and the date of this opinion.

III. CONCLUSION

Defendant Michael O'Higgins' motion for reconsideration is DENIED. Plaintiff CDPHP's motion for a preliminary injunction is also DENIED. The plaintiff's motion for Rule 54(b) certification of this court's prior grant of summary judgment upon the second cause of action in the amended complaint -- that is, the claim that O'Higgins breached his fiduciary duty to CDPHP -- is GRANTED.

Pursuant to Federal Rule of Civil Procedure 54(b) this court expressly DIRECTS the entry of final judgment upon the second cause of action in the amended complaint, decided in this court's previous partial summary judgment order, Doc. 72. The court expressly DETERMINES that there is no just reason to delay the entry of judgment as explained in Part II.B supra.

The clerk of the court is ORDERED to enter judgment in favor of plaintiff CDPHP and against defendant Michael O'Higgins in the amount of $ 2,677,645.45. This amount consists of $ 1,863,553.05 in damages and $ 814,092.40 in prejudgment [*50] interest.

It is So Ordered.

Dated: January 16, 1997

Syracuse, New York

HOWARD G. MUNSON

SENIOR UNITED STATES DISTRICT JUDGE

CDPHP Loss Computation for PAC-IO Purchase & Sale

Date of Computation: 9/18/96

Date	Event	Amount	Per Diem *	"As Of" Date
2/2/93	Purchase	-$ 5,139,222.37	-$ 1267.21	9/18/96
2/2/93	Accrued Interest	-$ 4,503.73	-$ 1.11	9/18/96
3/19/93	Correction	$ 5,139,222.37	$ 1267.21	9/18/96
3/19/93	Correction	$ 4,503.73	$ 1.11	9/18/96
3/19/93	Purchase	-$ 5,074,411.39	-$ 1251.22	9/18/96
3/19/93	Accrued Interest	-$ 4,446.82	-$ 1.10	9/18/96
3/25/93	Paydown	$ 135,633.42	$ 33.44	9/18/96
4/26/93	Paydown	$ 133,932.06	$ 33.02	9/18/96
5/25/93	Paydown	$ 132,222.03	$ 32.60	9/18/96
6/25/93	Paydown	$ 130,503.34	$ 32.18	9/18/96
7/26/93	Paydown	$ 128,776.06	$ 31.75	9/18/96
8/4/93	Sale	$ 1,320,862.79	$ 325.69	9/18/96

8/4/93	Accrued Interest	$ 6,269.89	$ 1.55	9/18/96
8/25/93	Paydown	$ 127,040.23	$ 31.32	9/18/96
9/21/93	Correction of Sale	-$ 1,320,862.79	-$ 325.69	9/18/96
9/21/93	Correction of Interest	-$ 6,269.89	-$ 1.55	9/18/96
9/21/93	Sale	$ 1,302,280.93	$ 321.11	9/18/96
9/21/93	Accrued Interest	$ 6,181.66	$ 1.52	9/18/96
9/30/93	Sale	$ 1,054,988.46	$ 260.13	9/18/96
10/13/93	Paydown	$ 63,746.97	$ 15.72	9/18/96
Total		-$ 1,863,553.05	-$ 459.51	

[*51]

Date	Event	No. of Days	Interest	Total
2/2/93	Purchase	1324	-$ 1,677,780.10	-$ 6,817,002.47
2/2/93	Accrued Interest	1324	-$ 1,470.31	-$ 5,974.04
3/19/93	Correction	1279	$ 1,620,755.85	$ 6,759,978.22
3/19/93	Correction	1279	$ 1,420.34	$ 5,924.07
3/19/93	Purchase	1279	-$ 1,600,316.42	-$ 6,674,727.81
3/19/93	Accrued Interest	1279	-$ 1,402.39	-$ 5,849.21
3/25/93	Paydown	1273	$ 42,574.03	$ 178,207.45
4/26/93	Paydown	1241	$ 40,983.21	$ 174,915.27
5/25/93	Paydown	1212	$ 39,514.46	$ 171,736.49
6/25/93	Paydown	1181	$ 38,003.29	$ 168,506.63
7/26/93	Paydown	1150	$ 36,515.95	$ 165,292.01
8/4/93	Sale	1141	$ 371,614.79	$ 1,692,477.58
8/4/93	Accrued Interest	1141	$ 1,763.99	$ 8,033.88
8/25/93	Paydown	1120	$ 35,083.99	$ 162,124.22
9/21/93	Correction of Sale	1093	-$ 355,981.57	-$ 1,676,844.36
9/21/93	Correction of Interest	1093	-$ 1,689.78	-$ 7,959.67
9/21/93	Sale	1093	$ 350,973.63	$ 1,653,254.56
9/21/93	Accrued Interest	1093	$ 1,666.00	$ 7,847.66
9/30/93	Sale	1084	$ 281,985.41	$ 1,336,973.87
10/13/93	Paydown	1071	$ 16,834.44	$ 80,581.41
Total			-$ 758,951.20	-$ 2,622,504.25

[*52] by 365 days per year

* Computed at 9% simple interest per year divided