

# Investor Claims Against Securities Brokers Under Michigan Law

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## Introduction

Thirty years ago Judge John Feikens of the Federal District Court for the Eastern District of Michigan decided *Leib v Merrill Lynch, Pierce, Fenner & Smith*.<sup>1</sup> Throughout the nation, *Leib* has long been considered to be a leading case on the common law duties and liability of securities brokers to their customers.<sup>2</sup> Approximately ten years after *Leib*, arbitration became nearly the exclusive forum for the resolution of investor claims against their stockbrokers.<sup>3</sup> Arbitration has led to a scarcity of judicial precedent and the significant absence of a uniform application of the law. Fundamental principles set forth in statutes and case law for assessing responsibility in the uncertain world of the securities markets are often misapplied or ignored in favor of nebulous standards for liability that result in a second-guessing of investment approaches.

On the thirty-year anniversary of *Leib*, we endeavor to set forth the legal standards under Michigan law for claims commonly asserted against securities brokers and their firms. This "getting back to basics" effort concerns liability for such claims as negligence, breach of fiduciary duty, suitability, breach of contract, churning, and misrepresentation.

## Negligence, Fiduciary Duties, and Suitability

### *In General*

The most prominent and profound casualty of the paucity of judicial guidance over the past several years is the application of law claims based on common law duties owed by securities brokers to investors. Whether couched as negligence, malfeasance, or breach of fiduciary duty, in arbitration these claims inevitably are reduced to a contest of suitability, or whether the investment in question was suitable under the rules of the National Association of Securities Dealers (NASD) or the New York Stock Exchange (NYSE).<sup>4</sup> The question of broker liability becomes a debate as to what, in hindsight, is an appropriate invest-

ment in light of the customer's financial situation, experience, and investment objectives. All too often, this debate becomes a competition among investment approaches in which experts duel over what should have been the proper "objective" investment strategy for the customer. As recognized by some commentators, the shift from court to arbitration "has eased meaningfully the customer's path to recovery."<sup>5</sup>

Under well-established Michigan law, however, such suitability considerations are paramount for determining liability only in the relatively rare situation where the broker has discretion in making investment decisions for the customer. In the vast majority of cases where prior customer authorization is required for each transaction, the touchstone for common law liability is improper disclosure, not the "suitability" of an investment.

### *The Suitability Rules and Suitability Actions*

The concept of suitability derives from rules of the NASD and NYSE. As self-regulatory organizations, the NASD and NYSE, which recently merged and are now called "FINRA," promulgate rules to govern the conduct of member firms, brokers, and other persons associated with member firms. Indeed, under the Securities Exchange Act, such self-regulatory organizations are required to promulgate rules "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade...[and] to protect investors and the public interest."<sup>6</sup>

The NASD "suitability" rule is set forth in NASD Rule 2310.<sup>7</sup> Subsection (a) provides:

In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.

Before making a recommendation, subsection (b) requires the broker to inquire of the "facts" referred to in subsection (a) by "mak[ing] reasonable efforts to obtain information" concerning the customer's financial status, tax status, and investment objectives. Accordingly, as informed by the NASD rule, suitability commonly is understood to require that, when a broker makes a recommendation to purchase or sell an investment, the broker has reasonable grounds to believe that the transaction is suitable for the customer's financial situation and investment objectives.

The NYSE does not have a similar rule. Instead, the Exchange has a "know your customer" rule, Rule 405.<sup>8</sup> Originally designed to protect brokerage firms financially, the Rule has been used to imply an amorphous suitability standard.<sup>9</sup> Rule 405 requires a broker to learn the "essential facts" concerning a customer and the nature of the account prior to opening it. Counsel for investors frequently argue that the rule requires the broker to ensure that the investments in the account are appropriate based on the essential facts. Interestingly, NYSE enforcement actions for "unsuitable investments" have not relied upon Rule 405.<sup>10</sup>

The NASD and NYSE rules are promulgated to regulate the conduct of member firms and those associated with member firms.<sup>11</sup> They may form the basis of disciplinary action, but are not alone a basis for civil liability or a formula for the proper awarding of damages to a customer. Indeed, Michigan courts have long held that there is no civil cause of action for the violation of a self-regulatory rule.<sup>12</sup> To do so would, among other reasons, discourage meaningful self-regulation.<sup>13</sup>

Nonetheless, customer arbitrations conducted in Michigan routinely assert some kind of suitability claim. Arbitration has brought a shift in the focus of broker liability from Section 10(b) of the Securities Exchange Act and Rule 10b-5 to the unsuitability rules of the NASD and NYSE, which, as one commentator has noted, embody "a comparatively nebulous, quasi-legal, quasi-ethical standard of due care and fair dealing between brokers and customers."<sup>14</sup> "Unsuitability claims" are the "most common yet most ambiguous of all client accusations."<sup>15</sup> Indeed, "[w]hat constitutes a viable unsuitability claim is open to debate."<sup>16</sup> Adding to the confusion is the citation by parties in arbitration to regulatory

enforcement action decisions concerning violations of the suitability rules as precedent for establishing civil liability.

As self-regulatory organizations, the NASD and NYSE had enforcement divisions that were authorized to bring actions against member firms and those associated with them for violations of the rules of the organizations or securities laws.<sup>17</sup> Such actions are brought pursuant to special rules of those regulatory organizations for enforcement proceedings.<sup>18</sup> Both the NASD and the NYSE have appeal processes.<sup>19</sup> Once those appeals have been exhausted, an appeal of the enforcement decision can be taken to the Securities and Exchange Commission (SEC).<sup>20</sup> The SEC also is authorized to bring enforcement actions against brokerage firms and individuals associated with them for violations of the federal securities laws.<sup>21</sup> The Commission can bring such enforcement actions in federal court or as administrative actions pursuant to its own rules.

Determinations in NASD or NYSE enforcement actions, in the administrative enforcement actions of the SEC, and in appeals to the SEC are issued in written form similar to court opinions. Advocates in arbitration regularly submit such determinations to arbitration panels as precedent concerning the suitability standard as though they were court decisions determining civil liability. But these determinations are far different from court decisions. First, they lack consistency and rarely define principles that can be applied to other cases.<sup>22</sup> Second, the focus of the disciplinary action is not determining civil liability in a dispute between two parties, but only evaluating the conduct of the broker. Indeed, NASD disciplinary panels have recognized the significantly different purposes of an enforcement action and a civil action for damages: an enforcement proceeding simply concerns the broker's conduct and the institution's internal rules and it does not concern administering justice between parties and basic principles of personal responsibility.<sup>23</sup>

Interestingly, the Michigan Uniform Securities Act contains a "suitability"-type provision. Section 204(a)(1)(M) provides that the administrator may "deny, suspend, or revoke any registration, or censure a registrant, if it finds" that the broker "recommended" an investment "without reasonable grounds to believe that the recommendation is suitable for the customer on the basis of information furnished by the customer after rea-

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sonable inquiry...concerning the customer's investment objectives, financial situation and needs."<sup>24</sup> Section 204(h), however, specifically states that a violation of that provision "shall not subject a registrant to civil liability to a customer."<sup>25</sup> Indeed, the Michigan Court of Appeals has found a cause of action based on the "suitability" standard of Section 204(a)(1)(M) to be "frivolous."<sup>26</sup>

*Liability Based on Disclosure and "Suitability"*

Although there have been few decisions concerning common law actions against securities brokers under Michigan law, *Leib*<sup>27</sup> has been the seminal decision enumerating the grounds for civil liability.<sup>28</sup> *Leib* defines broker duties and liability based on who is making the investment decision. A broker has a suitability-type duty only when the broker is unilaterally making the investment decision. When the customer must authorize each transaction in advance, broker liability is based on the adequacy of disclosure, not suitability. In the former or discretionary account circumstance, the claim against the broker is for breach of fiduciary duties. In the latter situation, the claim is in the nature of negligence or malfeasance.

In *Leib*, the plaintiff alleged that the defendant broker "churned" plaintiff's securities account (*i.e.*, engaged in excessive trading to generate commissions) and "breached his fiduciary duty by allowing [the plaintiff] to pursue a course of heavy trading which could not possibly have resulted in a profit."<sup>29</sup> In evaluating the plaintiff's breach of fiduciary duty claim, the court analyzed the general duties owed by a broker to his customers. The court found that brokers become fiduciaries when making the investment decision in a discretionary account — where prior customer authorization is not required — but are not fiduciaries for non-discretionary accounts.<sup>30</sup> This holding is consistent with the regulatory scheme of the federal securities laws. The Investment Advisors Act of 1940 creates fiduciary duties for advisors managing discretionary accounts or funds.<sup>31</sup>

The *Leib* court recognized that a broker managing a discretionary account must "manage the account in a manner directly comporting with the needs and objectives of the customer."<sup>32</sup> In addition to this "suitability"-type duty, the broker also has an ongoing duty of monitoring the account and disclo-

sure to the customer of events that impact the investment strategy of the accounts.<sup>33</sup>

The vast majority of accounts, however, are non-discretionary accounts in which prior customer authorization is required for transactions in the account. For such accounts, *Leib* predicates broker liability on limited duties with respect to each individual transaction. Regarding investment advice, those duties are to "recommend a stock only after studying it sufficiently to become informed as to its nature [and] price," "to inform the customer of the risks involved in purchasing or selling a particular security," to refrain from self-dealing or to disclose a personal interest in a transaction, and "not to misrepresent any fact material to the transaction."<sup>34</sup> Consequently, there is not a suitability standard, but a disclosure duty. Indeed, the *Leib* court stated:

Remarkably absent from the above list is the duty, on the part of the broker, to engage in a particular course of trading. So long as a broker performs the transactional duties outlined above, he and his customer may embark upon a course of heavy trading in speculative stocks or in-out trading as well as upon a course of conservative investment in blue chip securities.<sup>35</sup>

Thus, *Leib* specifically rejects liability based upon any prescribed or "objective" suitability standard, but imposes liability for inadequate disclosure. As one federal court summarized the predicates for liability set forth in *Leib*:

The limited duties that attach to brokers handling non-discretionary accounts do not require a broker to engage in a particular course of trading. As long as the customer so directs, the broker may embark upon a course of speculative trading without violating any duty to the customer....The only duties imposed upon the broker in this context are the minimal duty to inform the customer of the risks involved in purchasing or selling a particular security or investment and the duty to not misrepresent any material facts regarding a transaction.<sup>36</sup>

*Leib* reflects an approach to civil liability that accounts for personal responsibility and the uncertainty in the market. A customer who has been adequately apprised of the risks of an investment and decides to go for-

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ward with the investment should not be able to recover against the broker because the investment did not work out. *Leib* is contrary to the paternal approach of the suitability rule as frequently advocated in arbitration, which only evaluates the broker's conduct with respect to some kind of "objective" standard as to what constitutes an appropriate investment. Instead, *Leib* recognizes that it is the customer's money and the customer has the right and obligation to make informed choices in how to invest that money. *Leib* held that the broker has no duty to restrain the customer from "trading heavily."<sup>37</sup> As long as the customer controls the account, the pattern of trading is the customer's responsibility.<sup>38</sup> This approach stresses personal responsibility for informed choices and does not permit recovery against the broker for the consequences of those choices. In making disclosure the keystone for broker liability, *Leib* is consistent with the approach of the federal securities laws in regulating the issuance and trading of securities. Both the Securities Act of 1933 and the Securities Exchange Act of 1934 impose a "philosophy of full disclosure."<sup>39</sup>

Recognizing the possibility of abuse, *Leib* also addresses the issues of meaningful consent and broker manipulation. *Leib* measures the adequacy of the disclosure based on the customer's particular situation.<sup>40</sup> The broker's disclosure duties will vary depending on the intelligence and personality of the customer.<sup>41</sup> "Uneducated" or "unsophisticated" customers will require careful and cautious disclosure.<sup>42</sup> Moreover, the broker is required to disclose self-dealing or personal interest.<sup>43</sup> Additionally, *Leib* also sets forth an analysis for accessing customer control.<sup>44</sup>

A broker can usurp control of a non-discretionary account and assume the fiduciary duties of a discretionary account under certain circumstances. According to *Leib*, the court is to weigh several factors in assessing whether the broker assumed control. Those factors include (1) the age, education, intelligence and prior investment experience of the customer, (2) the nature of the customer-broker relationship — in other words, do the facts show an arms-length relationship or a personal relationship of trust and confidence, (3) the broker placing transactions without prior customer approval, and (4) the frequency of communications between the customer and broker.<sup>45</sup>

The broker will not be deemed to control an account, however, solely because all the trades in the account were the result of the broker's recommendation or because the customer always follows the broker's advice.<sup>46</sup> *Leib* recognizes that a "customer normally depends upon his broker to supply information, advice and recommendations."<sup>47</sup> Many courts have recognized that control is not a matter of broker recommendation, but the client's capacity to "exercise the final right to say 'yes' or 'no'."<sup>48</sup>

Although the basis for liability in non-discretionary accounts under the *Leib* approach is significantly different from that under the suitability rule, many of the proofs will be the same with respect to meaningful consent and broker control. Thus, issues pertaining to suitability such as the customer's education, prior investment experience, and the complexity of the investment also will be relevant to the *Leib* analysis. The *Leib* standard, however, does not invite the battle of the experts concerning "appropriate" investment strategies, typically driven by hindsight and advocacy. Rather than this less than meaningful debate, the *Leib* standard focuses only on knowing consent.<sup>49</sup>

### Breach of Contract

Investors frequently join a breach of contract claim with other claims such as negligence and breach of fiduciary duty. Although there are reported decisions of Michigan courts and federal courts applying Michigan law indicating that plaintiff investors have alleged a breach of contract claim,<sup>50</sup> there is no such reported decision that sets forth the elements of a breach of contract claim against a securities broker. Consequently, the scope of a breach of contract claim under Michigan law is not firmly established.

Breach of a term of a written agreement between the investor and brokerage firm or a specific oral agreement is sound basis for a claim of breach of contract.<sup>51</sup> The difficulty is when a claimant investor attempts to allege suitability-type duties as a contractual obligation. For example, the investor in *The Ohio Co v Nemecek*,<sup>52</sup> asserted a breach of contract claim for "unsuitable" investments that the brokerage firm allegedly induced the investor to make "without proper disclosure of the characteristics and risks of ownership" and "made misrepresentations to them concerning their investments."<sup>53</sup> While the *Nemecek* court was not asked to rule on the viability

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of such a claim, courts in other jurisdictions have recognized breach of contract claims for excessive trading and suitability-type allegations as the basis for an action for failure to exercise due care and not for breach of contract.<sup>54</sup> Courts also have recognized a breach of contract action for the mismanagement of an account premised on a supposed "implied agreement" that the account would be handled properly.<sup>55</sup> These implied contractual claims generally concern the same allegations and proofs as common law negligence, malfeasance, or breach of fiduciary duty claims.<sup>56</sup> The investor generally is attempting to "contractualize" a purported duty or obligation as an implied contract right, perhaps to avoid a statute of limitation or other defense.<sup>57</sup>

Michigan courts have a longstanding history of rejecting breach of contract claims based on the breach of an implied contractual term that essentially is to act with due care. For example, in legal malpractice cases, Michigan courts look beyond the breach of contract label the plaintiff has given a claim and analyze the "gravamen of the action."<sup>58</sup> A breach of contract claim cannot be maintained where the "'contractual' duties allegedly breached by defendant are indistinguishable from the duty to render legal services in accordance with the applicable standard of care."<sup>59</sup> A viable breach of contract claim requires a "special contract" between the client and attorney in which the attorney promises a specific action.<sup>60</sup>

Analytically, breach of contract claims by investors against securities brokers should be treated in the same manner as claims against lawyers. Both are professional service relationships and both have certain duties of care imposed by law. Further, the interests of avoiding duplicity of claims cited by courts in the legal malpractice cases<sup>61</sup> fully apply to securities brokers.

### Churning

Not every claim by an investor concerns allegations of problems with the particular securities purchased by their broker. Another frequent claim is that the broker improperly engaged in too many transactions for the purpose of generating commissions. While a certain level of trading is necessary to conduct business, investors frequently make claims that the trading was excessive. This is most commonly known as a claim for "churning."

Churning is defined as fraudulent overtrading to inflate commissions.<sup>62</sup> Important-

ly, it is not defined simply as having large commissions, or having too many trades, but rather requires the causal link of overtrading that is intended to inflate commissions.<sup>63</sup> Because of that link, a churning claim is analogous to a fraud claim and is treated similarly.<sup>64</sup> A claimant must be able to establish three separate elements to succeed on a churning claim.<sup>65</sup> First, there must have been trading that was excessive in light of the customer's investment objectives.<sup>66</sup> Second, the trading must have taken place in an account controlled by the broker — not the customer.<sup>67</sup> Finally, the broker must have acted with either an intent to defraud the investor or with reckless disregard for the customer's interest.<sup>68</sup>

The difference between arbitration and traditional litigation in court is particularly relevant here. Because churning is treated as a type of fraud claim, the three elements of the claim would have to be pled with particularity if the claim was brought in court.<sup>69</sup> If brought in arbitration, however, a claimant need only plead the relevant facts and relief requested.<sup>70</sup> This significantly lower pleading standard permits investors to bring churning claims in arbitration that they may not be able to maintain in court.

Excessive trading in light of investment objectives can be demonstrated by several different factors, including the turnover ratio of the account, the ratio of account value to commissions, in and out trading, and the number and frequency of trades.<sup>71</sup> No one of these factors is determinative of trading, but collectively, the factors provide for a "measure of objectivity"<sup>72</sup> that helps parties determine whether trading was, in fact, churning.

The turnover ratio of an account<sup>73</sup> is commonly viewed as the principal indicator of churning. Various courts and industry commentators have agreed that trading is generally excessive where the turnover ratio is greater than six.<sup>74</sup> However, lesser turnover amounts have also been found to be excessive. The number and frequency of trades is a related factor, which can arise where there are numerous smaller trades, but the total turnover ratio remains low. Further, the ratio of account value to commissions can also indicate churning, but only where the commissions themselves are shown to be excessive.<sup>75</sup> Also, "in and out" trading can be a characteristic of churning when there is a pattern of selling securities, investing the proceeds in a

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new security, then quickly selling that new investment.<sup>76</sup>

Even where these factors are present, however, a claimant must establish that the broker controlled the account. Control, for purposes of churning, is much like the control discussed above regarding fiduciary duties and suitability. The primary test is where the final decision to trade lies—is it with the customer or with the broker?<sup>77</sup> A broker does not exercise control over an account by making the trades received from the customer,<sup>78</sup> but he or she may do so by disregarding instructions, converting accounts to margin, or engaging in unauthorized trades.<sup>79</sup>

Finally, an investor must show that the broker acted with either an intent to defraud or with reckless disregard of the investor's interests.<sup>80</sup> However, this element can be broadly construed to include the misappropriation of client funds, inappropriate use of margin, providing a customer with misleading information, or conducting unauthorized transactions.<sup>81</sup>

### Misrepresentation

Many of the common securities claims discussed in this article involve some aspect of fraud or misrepresentation, which can constitute a separate claim under both Michigan and federal law.<sup>82</sup> Under Michigan statutory law, Michigan common law, and federal law, there is a prohibition against using misrepresentations in connection with the sale of a security. Each of these three bases for a fraud claim requires similar proofs, but has different elements.

Under Michigan common law, a fraud claim requires the proof of six elements:

- (1) the defendant made a material representation; (2) the representation was false; (3) when the defendant made the representation, the defendant knew that it was false, or made it recklessly, without knowledge of its truth as a positive assertion; (4) the defendant made the representation with the intention that the plaintiff would act upon it; (5) the plaintiff acted in reliance upon it; and (6) the plaintiff suffered damage.<sup>83</sup>

The most common federal misrepresentation claim asserted against securities brokers is the implied cause of action under Section 10(b) of the Securities Exchange Act of 1934<sup>84</sup> and SEC Rule 10b-5.<sup>85</sup> The federal claim is similar to common law fraud in its elements:

To establish a violation of §10(b) of the 1934 Act, the plaintiff has the burden of establishing that the alleged misrepresentation or omission was (1) one of material fact, (2) made with scienter, (3) on which plaintiff reasonably relied, and (4) which proximately caused the plaintiff's damages.<sup>86</sup>

The touchstone of liability for fraud claims is a *material* misrepresentation. Not all misstatements are considered material. To the contrary, a misstatement is material only if it "would have likely influenced a reasonable investor to change his mind, given the 'total mix' of information available to him in the individual case."<sup>87</sup> The standard is objective and is not dependent on the particular perspective of the investor claimant. Thus, while a momentum trader<sup>88</sup> would believe it is significant that a company missed revenue forecasts by one cent, courts have found such factors to be immaterial as a matter of law.<sup>89</sup> Similarly, adequate disclosure does not depend on providing a specific interpretation of the facts that might assist in the investor having a better understanding.<sup>90</sup> All that is required is clearly stating the facts.

While Section 410(a)(e) of the Michigan Uniform Securities Act<sup>91</sup> also provides a cause of action based upon an "untrue statement of a material fact," the express language of the statute does not require the investor claimant to show reliance on the alleged misrepresentation or the intent to defraud, which is known as a "scienter" in the federal case law for an implied claim under Section 10(b) of the Securities and Exchange Act.<sup>92</sup> The claimant need only show that a material misrepresentation was made in the offer or sale of a security and the claimant "did not know, and in the exercise of reasonable care could not have known, of the untruth or omission."<sup>93</sup> Similar to materiality, whether an investor should have been on notice that a statement is untrue is measured by an objective standard—i.e., did the investor exercise reasonable care.

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## NOTES

1. *Leib v Merrill Lynch, Pierce, Fenner & Smith*, 461 F Supp. 951 (ED Mich 1978).
2. See, e.g., *De Kwiatkowski v Bear, Stearns & Co*, 306 F3d 1293, 1302 (2d Cir 2002); *Gochmauer v AG Edwards & Sons, Inc*, 810 F2d 1042, 1049-50 (11th Cir 1987); *Burns v Prudential Sec, Inc*, 167 Ohio App 3d 809, 857 NE2d 621, 635-36 (Ohio Ct App 2006); *Davis v Keyes*, 859 F Supp 290, 294 (ED Mich 1994); *First of Michigan Corp v Swick*, 894 F Supp 298, 300 (ED Mich 1995); R. Haft & P. Fass, *Tax-Advantaged Securities: ILPs, Pass-Throughs and Other Vehicles*, 4 Tax-Advantaged Sec. 2.05[7][b] (2000) (“*Leib* has become the leading case with respect to [common law] duties”).
3. In 1987, the Supreme Court decided *Shearson/American Express, Inc v McMahon*, 482 US 220 (1987), in which the Court recognized that federal securities claims could be subject to arbitration.
4. The enforcement and dispute resolution divisions of the NASD and NYSE merged into the Financial Industry Regulatory Authority. As of the writing of this article, the NASD and NYSE rules have not been replaced with “FINRA” rules.
5. L. Lowenfels & A. Bromberg, *Suitability in Securities Transactions*, 54 Bus Law 1557, 1558 (Aug 1999).
6. 15 USC 78f(b)(5) (pertaining to the NYSE as a national securities exchange) and § 78o-3(b)(6) (pertaining to the NASD as a national securities association). Interestingly, the enforcement authority of the NYSE and NASD over their members is more extensive than that of the Securities and Exchange Commission because they enforce not only the federal securities laws, but also internal ethical standards. 2 Marc I. Steinberg & Ralph C. Ferrara, *Self-Regulatory Organization Enforcement Practice*, in *Securities Practice, Federal and State Enforcement*, § 13:02, at 4 (1995).
7. NASD Conduct Rule 2310.
8. NYSE Rule 405.
9. Lowenfels & Bromberg, *supra*, at 1571.
10. *Id.* at 1572.
11. NASD Rule 0115.
12. See, e.g., *Hartmann v Shearson Lehman Hutton, Inc*, 194 Mich App 25, 31, 486 NW2d 53 (Mich Ct App 1992) (no common law cause of action for violating NASD rules); *Kirkland v EF Hutton & Co*, 564 F Supp 427, 443 (ED Mich 1983).
13. See, e.g., *Kirkland*, 564 F Supp at 443 (“The likely outcome of permitting civil damage actions for violations of [NYSE and NASD] rules would be to discourage the stock exchange and the dealers association from promulgating rules for the protection of the investing public, an undesirable result.”); *JE Hoetger & Co v Ascencio*, 572 F Supp 814, 822 (ED Mich 1983) (to allow private cause of action based on firm’s violation of internal rules “would impose the greatest additional liability on those firms policing themselves rigorously...effectively punishing the diligent and favoring the lax.”); *De Kwiatkowski v Bear, Stearns & Co*, 306 F3d 1293, 1311 (2d Cir 2002) (“As a policy matter, it makes no sense to discourage the adoption of higher standards than the law requires by treating them as predicates for liability.”).
14. Lowenfels & Bromberg, *supra*, at 1585.
15. Lowenfels & Bromberg, *supra*, at 1557.
16. *Id.*
17. 15 USC 78f(d); NASD Rule 8310(a); NYSE Rule 476. As previously stated, the NASD and NYSE enforcement divisions recently have been combined into one organization known as “FINRA.” FINRA simply adopted the NASD rules regarding investigations, enforcement and arbitration.
18. NASD Rules 9110-9870; NYSE Rules 475-477. Enforcement proceedings are now governed by FINRA Rules 9110 – 9870.
19. NASD Rule 9311; NYSE Rules 475-76; FINRA Rule 9311.
20. NASD Rule 9370; NYSE Rules 475-76; FINRA Rule 9370.
21. SEC Rule of Practice 200.
22. Lowenfels and Bromberg observed that in disciplinary actions under the suitability rules “the line between conduct which is suitable and conduct which is unsuitable under the SRO rules remains ambiguous and uncertain.” L. Lowenfels & A. Bromberg, *supra*, at 1575.
23. In *Dept of Enforcement v Kernweis*, 2000 WL 33299605 (NASDR) (Disciplinary Proceeding No. C02980024) (Feb. 16, 2000), the panel stated: “there is a difference between a disciplinary proceeding and a private action for damages. It may well be that [the customer] also was at fault and could not recover in a suit for damages. The focus of a disciplinary proceeding, however, is the conduct of the registered representative.” See also *Hecht v Harris, Upham & Co*, 283 F Supp 417, 431 (ND Cal 1968).
24. MCL 451.604(a)(1)(M).
25. MCL 451.604(h). It is noteworthy that the Michigan legislature amended Section 204 (451.604) in 2000 and did not modify the prohibition against civil liability.
26. *Hartmann*, 194 Mich App at 31.
27. *Leib*, 461 F Supp 951 (ED Mich 1978).
28. See note 3, *supra*. There are rare Michigan decisions that do not fully follow the *Leib* analysis. These decisions do not disagree or distinguish *Leib*, but simply do not even mention *Leib*. See, e.g., *John v Shearson/American Express, Inc*, 732 F Supp 728 (ED Mich 1989). Moreover, those decisions are not significantly relied upon by later courts.
29. *Leib*, 461 F Supp at 952.
30. *Id.* at 953. There are occasional decisions that confuse the distinction between discretionary and non-discretionary accounts in their analysis. See *Vestax Sec Corp v Desmond*, 919 F Supp 1061 (ED Mich 1995). *Desmond* is particularly confused because the “broker” was actually acting as a registered investment advisor. *Id.* at 1064. Under the Investment Advisor’s Act of 1940, a broker acting in that capacity would be deemed a fiduciary. 15 USC 806-6.
31. 15 USC 806-6.
32. *Leib*, 461 F Supp at 953.
33. *Id.*
34. *Id.* *Leib* also listed such other indicia of potential liability as failing to carry out the customer’s orders promptly and failing to obtain customer authorization prior to executing a transaction. The Second Circuit in *De Kwiatkowski v Bear, Stearns & Co*, 306 F3d 1293, 1302 (2d Cir 2002), eloquently summarized the *Leib* predicates for broker liability in a non-discretionary account as: “On a transaction-by-transaction basis, the broker owes duties of diligence and competence in executing the client’s trade orders, and is obliged to give honest and complete information when recommending a purchase or sale.”
35. *Leib*, 461 F Supp at 953.
36. *Prudential Bache Sec, Inc v Pitman*, 1991 US Dist LEXIS 10056, \*11 FedSecLRpt (CCH) ¶ 96, 170 (ND Ga 1991) (citations omitted). See, e.g., *Follansbee v Davis, Skaggs & Co*, 681 F2d 673, 677 (9th Cir 1982) (rejecting broker liability for speculative investments because “the customer ha[d] sufficient intelligence and understanding to evaluate the broker’s recommendation and to reject one when he thinks it unsuitable.”).
37. *Leib*, 461 F Supp at 956.



38. *Id.* at 956-57. See also *Platts v EF Hutton & Co*, 642 F Supp 1277, 1309 (WD Mich 1986), *aff'd*, 829 F2d 13 (6th Cir 1987) (applying *Leib* and holding that "in a non-discretionary account, the customer may not complain if he knowingly selects an investment.").
39. See, e.g., *SEC v Capital Gains Research Bureau, Inc.*, 375 US 180, 186 (1963).
40. *Leib*, 461 F Supp at 953.
41. *Id.*
42. *Id.*
43. *Id.*
44. *Id.* at 954.
45. *Id.* at 954-55.
46. *Id.* at 956. See, e.g., *Ohio Co v Nemecek*, 886 F Supp 1342, 1347 (ED Mich 1995) ("Petitioners, as brokers, had a duty to make recommendations based on their skill and knowledge, but the fact that the [customer] followed their advice does not alone constitute usurpation of control so as to impose a fiduciary relationship on petitioners as to the [customer's] non-discretionary account.").
47. *Leib*, 461 F Supp at 956.
48. *Follansbee*, 681 F2d at 677. See, e.g., *M&B Contracting Corp v Dale*, 601 F Supp 1106, 1111 (ED Mich 1984), *aff'd*, 795 F2d 531 (6th Cir 1986) ("As long as the customer has the capacity to exercise the final right to say 'yes' or 'no,' the customer controls the account.").
49. This approach also is consistent with the approach of various courts that treated suitability claims as misrepresentation claims. E.g., *Brunetti v Roney & Co*, 807 F Supp 62, 64 (ED Mich 1992).
50. See, e.g., *Ohio Co v Nemecek*, 98 F3d 234, 235 (6th Cir 1996); *Vestax Sec Corp*, 919 F Supp at 1063, n.1; *Moncrieff v Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 623 F Supp 1005, 1006 (ED Mich 1985).
51. See, e.g., *Pross v Baird, Patrick & Co, Inc.*, 585 F Supp 1456, 1458 (SDNY 1984); 2 Norman S. Posner & James A. Fanto, *Broker-Dealer Law and Regulation*, § 16.5[D], p. 16-149 (4th ed.).
52. *Nemecek*, 98 F3d 234 (6th Cir 1996).
53. *Id.*, at 235.
54. See, e.g., *Klock v Lehman Brothers Kuhn Loeb, Inc.*, 584 F Supp 210, 213, 221 (SDNY 1984). In *Klock*, the Court required the plaintiff investor to establish that the broker was engaged by contract to act on behalf of the investor and that "all liability alleged in the complaint had its genesis in the contractual relationship." *Id.* at 220.
55. Posner & Fanto, *supra*, pp. 16-149, 16-150.
56. *Id.*
57. For example, in Michigan, claim for breach of fiduciary duty or negligence against securities brokers are subject to the three-year statute of limitation of MCL 600.5805(10). *Lantz v Private Satellite Television, Inc.*, 813 F Supp 554, 556 (ED Mich 1993). A breach of contract claim is subject to the six-year period provided in MCL 600.5807. See Posner & Fanto, *supra*, p. 16-149.
58. *Aldred v O'Hara-Bruce*, 184 Mich App 488, 490, 458 NW2d 671 (1990). See also, *Seebacher v Fitzgerald, Hodgman, Cawthorne & King, PC*, 181 Mich App 642, 646, 449 NW2d 673 (1990).
59. *Brownell v Garber*, 199 Mich App 519, 525, 503 NW2d 81 (1993). See also, *Besman v Weiss*, 11 Mich App. 528, 531, 161 NW2d 599 (1968).
60. *Brownell*, 199 Mich App at 525.
61. *Id.*
62. *Todorov v Alexander*, 236 Mich App 464, 465-66, 600 NW2d 418 (1999); *Craighead v EF Hutton & Co*, 899 F2d 485, 489 (6th Cir 1990).
63. *Craighead*, 899 F2d at 489.
64. *Id.*; *Brunetti*, 807 F Supp. at 64.
65. *Id.*
66. *Todorov*, 236 Mich App at 467; *Katz v First of Michigan*, 1989 US Dist LEXIS 19141 at \*15 (WD Mich 1989); *Craighead*, 899 F2d at 489.
67. *Craighead*, 899 F2d at 489; *Katz*, 1989 US Dist LEXIS 19141 at \*15.
68. *Craighead*, 899 F2d at 489; *Katz*, 1989 US Dist LEXIS 19141 at \*15.
69. *Craighead*, 899 F2d at 489; *Brunetti*, 807 F Supp at 64 (dismissing churning claim for failure to specify facts supporting elements of claim).
70. NASD Rule 12302(a)(1).
71. *Craighead*, 899 F2d at 490; *Costello v Oppenheimer & Co.*, 711 F2d 1361 (7th Cir 1983).
72. *Craighead*, 899 F2d at 490 (quoting *Costello*, 711 F2d at 1369 n.11).
73. The turnover ratio is the number of times the total value of the investments in the account are replaced in a given year. For example, if the account value is \$10,000, and the total amount of purchases in the account in one year is \$50,000, the turnover would be 5 ( $\$50,000/\$10,000 = 5$ ).
74. *Craighead*, 899 F2d at 490 (citing *Siegel v Tucker, Anthony & RL Day, Inc.*, 658 F Supp 550, 554 (SDNY 1987); *Mihara v Dean Witter & Co*, 619 F2d 814, 821 (9th Cir 1980); and *Churning by Securities Dealers*, 80 Harv L Rev 869 (1967)).
75. *Craighead*, 899 F2d at 491.
76. *Id.* at 490 n.2 (citing *Costello*, 711 F2d at 369 n.9).
77. *Leib*, 461 F Supp at 956.
78. *Id.*
79. *Craighead*, 899 F2d at 491 n.4.
80. *Id.* at 489; *Katz*, 1989 US Dist LEXIS 19141 at \*15.
81. Seth C. Anderson and John F. Robertson, *Anatomy of a Churning Claim*, *Journal of Financial Planning*, Sept. 2000 at 145.
82. 15 USC §78j(b); MCL 451.501(2).
83. *M&D, Inc v WB McConkey*, 231 Mich App 22, 27, 585 NW2d 33 (1998).
84. 15 USC § 78j.
85. 17 CFR § 240.10b-5.
86. *Parkhurst v North American Fin Servs Co*, 919 F Supp 270, 273 (ED Mich 1996).
87. E.g., *Garvin v Ehlen*, 865 F2d 257 (6th Cir 1988) (citing *Basic Inc v Levinson*, 485 US 224, 229 (1988); *TSC Indus, Inc Northway, Inc*, 426 US 438, 449 (1976)); *People v Cook*, 89 Mich App 72, 83, 279 NW2d 579 (1979); *Prince v Heritage Oil Co*, 109 Mich App 189, 203, 311 NW2d 741 (1981).
88. A momentum trader attempts to pick stocks of companies that consistently meet or exceed forecasts.
89. *Greenberg v Compuware Corp*, 889 F Supp. 1012, 1022 (ED Mich 1995).
90. *Ley v Visteon Corp*, No 06-2237, 2008 WL 4460192 (6th Cir Oct. 6, 2008).
91. MCL 451.810(a)(2).
92. E.g., *Molecular Tech Corp v Valentine*, 925 F2d 910, 920 n7 (6th Cir 1991) (Michigan Uniform Securities Act does "not require a specific intent to defraud").
93. MCL 451.810(a)(2).





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