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Via electronic filing: rule-comments@sec.gov

August 6, 2018

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: File Number S7-07-18

Comment Ltr. #2: (Proposed) Regulation Best Interests

Dear Chair Clayton, Commissioners and Staff of the U.S. Securities and Exchange Commission:

As a researcher regarding the application of fiduciary law to the delivery of financial planning and investment advice,¹ I submit these comments. *This letter is submitted on my own behalf, and not on behalf of any organization, firm, or institution to which I belong or may be affiliated.*

I have separately provided a comment letter, this same date, with regarding to “Proposed Interpretation of Fiduciary Duties Arising Under the Advisers Act.” This separate comment letter seeks to inform the Commission that satisfaction of the fiduciary duty of loyalty requires, when a conflict of interest is present, not just disclosure and consent, but rather “informed consent” and the additional requirement that the transaction remain substantively fair to the client. I assume, for purposes of this letter, that the reader understands the *bona fide* fiduciary standard of conduct – as set forth in my separate comment letter – for in this letter comparisons will need to be made between “suitability” and the proposed “Regulation Best Interests” and the requirements of fiduciaries under the Investment Advisers Act of 1940 and state common law. Accordingly, I incorporate that comment letter by reference, herein.

¹ I am attorney-at-law for 32 years, an registered investment adviser representative for 17 years, a participant in financial advisory association committees and boards and as a speaker at conferences and symposia – and a researcher and commentator on fiduciary law as applied to financial services – for over 14 years, and a professor of finance and financial planning providing instruction in investments and financial planning for the past 6 years.¹ *This comment letter is submitted on my own behalf, and not on behalf of any institution, organization, association or firm with whom I may be associated.*

INTRODUCTION

In this correspondence I urge the Commission to reverse course and to not adopt proposed Regulation Best Interests (“Regulation BI”)² for the following primary reasons:

- The term “best interests” is an expression of the fiduciary standard.
- The Commission’s proposed Regulation BI exacerbates, rather than lessens, consumer confusion between the sellers of products and the providers of advice.
- The Commission’s proposal also opens up brokers to liability as common law fiduciaries.
- Should it adopt Regulation Best Interests, the Commission would open itself up to the charge of aiding and abetting fraudulent conduct.

I commence my comments with these two pertinent quotations, demonstrating first, in the thrust of this comment letter, that the fiduciary duty of loyalty is defined as acting in the best interests of the client – and any attempt to undermine the meaning of “best interests” is nothing less than an erosion of the fiduciary standard of conduct – the highest standard of conduct under the law.

“The duty of loyalty requires an *adviser* to serve the *best interests* of its clients, which includes an obligation not to subordinate the clients’ interests to its own.”³

Second, that the Commission should never assist the brokerage industry in committing fraud, by permitting a broker to state that he or she acts in the best interests of the customer – when in fact, by the express terms of the proposed Regulation Best Interests – the broker is under no requirement to so act.

“The relationship between a customer and the financial practitioner should govern the nature of their mutual ethical obligations. Where the fundamental nature of the relationship is one in which customer depends on the practitioner to craft solutions for the customer’s financial problems, the ethical standard should be a fiduciary one that the advice is in the best interest of the customer. To do otherwise – to give biased advice with the aura of advice in the customer’s best interest – is fraud. This standard should apply regardless of whether the advice givers call themselves advisors, advisers, brokers, consultants, managers or planners.”⁴ [Emphasis added.]

² Regulation Best Interest, Exchange Act Release No. 34-83062 (April 18, 2018) (“Regulation Best Interest Proposal”).

³ Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011) (hereafter “SEC Staff 2011 Study”), available at www.sec.gov/news/studies/2011/913studyfinal.pdf, at p. 22.

⁴ James J. Angel, Ph.D., CFA and Douglas McCabe Ph.D., *Ethical Standards for Stockbrokers: Fiduciary or Suitability?* (Sept. 30, 2010).

A. “WHOM DO YOU REPRESENT?” A BROKER CAN REPRESENT THE SELLER, OR THE PURCHASER, BUT NOT BOTH.

A brokerage firm and its representatives can either represent the seller, or the purchaser, but not both. Permitting a brokerage firm and its representatives to state that they act in the “best interests” of their customers, when in fact their duties flow to the product manufacturer or issuer of the security (or to their own interests, when selling proprietary products or otherwise acting as a dealer), only permits falsehood. The Commission’s proposal, by stating that a broker-dealer acts in the “best interests” of the customer, while utilizing a safe harbor and permitting the use of disclaimers by firms, in essence creates only the illusion of protection – i.e., the Commission creates a fallacy.

As was well-known in the early case law: "The principle is undeniable that an agent to sell cannot sell to himself, for the obvious reason that *the relations of agent and purchaser are inconsistent*, and such a transaction will be set aside without proof of fraud."⁵

In an early speech by the Louis Loss, for long the leading scholar on the federal securities law, presented at a time when he served the Commission, Professor Loss stated: “[A]s an eloquent Tennessee jurist put it before the Civil War, the doctrine ‘has its foundation, not so much in the commission of actual fraud, but in that profound knowledge of the human heart which dictated that hallowed petition, ‘Lead us not into temptation, but deliver us from evil,’ and that caused the announcement of the infallible truth, that ‘a man cannot serve two masters.’ ”⁶

The Commission should conclude that Regulation Best Interests requires the broker to “step into the shoes of the customer” and truly act in the best interests of the customers at all times, and the Commission should appropriately reverse course.

B. THE COMMISSION ONCE CAUTIONED BROKERS AGAINST CAUSING CONSUMER CONFUSION, YET WITH PROPOSAL IT ABANDONS THE PRINCIPLE: “SAY WHAT YOU DO, DO WHAT YOU SAY”

Brokers (i.e., registered representatives) should clearly and accurately state, if they desire to avoid fiduciary duties under the law, that the interests of the customer are adverse to the interests of the broker (and her or his firm). Brokers represent the seller, or product manufacturer, when the customer is purchasing a security or a financial product. Brokers are merchants. Brokers are salespeople. They should confine their activities to sales activities. If they choose to engage in the delivery of financial and investment advice, or if they hold themselves out as doing same through the use of titles or other advertising, then broad fiduciary standards of conduct should be imposed upon them.

Brokers have changed the nature of their business to provide personalized investment advice and to form relationships of trust and confidence with their customers. During the course of the 20th Century brokers have shifted from the role of merchandizer, in which they used the terms “registered representative” or “sales representative” to describe themselves, to the role of trusted advisor using titles⁷ denoting

⁵ *Porter v. Wormser*, 94 N. Y. 431, 447 (1884). (*Emphasis added*.)

⁶ Address entitled “The SEC and the Broker-Dealer” by Louis Loss, Chief Counsel, Trading and Exchange Division, U.S. Securities and Exchange Commission on March 16, 1948, before the Stock Brokers’ Associates of Chicago.

⁷ In recent years massive marketing campaigns by Wall Street firms have touted their “objective advice” from “financial consultants” who attended their client’s soccer games and made so many believe that the “advice”

relationships of trust and confidence and employing trust-based sales techniques.⁸ Having transformed their businesses to incorporate the delivery of financial⁹ and investment advice, they should be willing to assume the duties and obligations which flow as a result of fiduciary status.

received would result in the ability to afford that second home on the beach. Even long-respected firms like Goldman Sachs have been perceived, at least at times and by some, to “throw clients under the bus” [see <http://theweekinethics.wordpress.com/2012/03/22/the-week-in-ethics-goldman-sachs-2012-problem-with-culture/>], apparently in violation of their adopted Code of Business Conduct and Ethics in which the firm commits “to conduct our business in accordance with ... the highest ethical standards.”

Slowly the clients of broker-dealer firms have realized the harm to which they have been subjected. Not quickly, and not all the time, of course. “[I]ndividuals continue to trust beyond the point where evidence points to the contrary. Eventually, however, the accumulated weight of evidence turns them towards distrust, which is equally reinforcing.” [Anand, Kartik, Gai, Prasanna and Marsili, Matteo, Financial Crises and the Evaporation of Trust (November 16, 2009). Available at SSRN: <http://ssrn.com/abstract=1507196>.]

However, in recent years some courageous journalists have noted that many conflicts of interests exist between product salespersons (however disguised they might be by the use of titles). They have noted that “financial consultants” and “wealth managers” are seldom in a “fiduciary relationship” with their customers, even though most customers believe they can “trust” their advisor. Many studies confirm consumer confusion.

⁸ The Commission has yet to clearly inform brokers that the use of trust-based sales techniques results in the application of fiduciary standards of conduct. In the latter half of the 20th Century, sales techniques evolved, as did salespersons’ view of themselves. Codes of ethics were developed, high-pressure sales techniques sometimes disavowed, and needs-based selling became a new paradigm. This evolved into “trust-based selling” and substantial changes in the sales process, with trust as a focus:

In the past few years, many authors have recognized that in the ‘relational era’ there have been radical changes in sales-force activities and sales management practices (Darmon, 1997; Marshall, Moncrief and Lassk, 1999; Wotruba, 1996). In brief, salesmen are expected to become value creators (De Vincentis and Rackham, 1996), customer partners and sales team managers (Weitz and Bradford, 1999), market analysts and planners (Wilson, 1993), and to rapidly shift from a hard selling to a smart selling approach (Sujan, Weitz and Kumar, 1994; Kohli, Shervani and Challagalla, 1998) ... trust is a focal construct in the analysis of relationship marketing (see for example Blois, 1996; Doney and Cannon, 1997; Kumar, 1996; Morgan and Hunt, 1994).

Paulo Guenzi, “Sales-Force Activities and Customer Trust.”

Where do we stand today? In the 2nd edition of the textbook, *SELL* (Cengage Learning, 2012), Professors Ingram, LaForge et. al. state that trust, when used as a sales technique, answers these questions: “1. Do you know what you are talking about? – competence; expertise; 2. Will you recommend what is best for me? – customer orientation; 3. Are you truthful? – honesty; candor; 4. Can you and your company back up your promises? – dependability; 5. Will you safeguard confidential information that I share with you? – customer orientation; dependability.” (*SELL*, p.27).

In looking closely at this list, it appears that questions 1, 3 and 5 are closely associated with the fiduciary duty of care. Question 2 is close to the proposition of “acting in the client’s best interests” – one of the major aspects of the fiduciary duty of loyalty. And Question 3, acting with honesty and candor, translates into the fiduciary duty of utmost good faith.

⁹ The use of financial planning services as a means to sell securities in order to generate profits by brokers was criticized early on by the SEC:

Between May 1960 and June 1964, registrant, together with or willfully aided and abetted by Hodgdon, Haight, Carr, Adam, Harper, Kitain, Davis and Kibler, engaged in a scheme to defraud customers who utilized registrant's financial planning services in the purchase and sale of securities, in willful violation of Section 17(a) of the Securities Act of 1933 and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder. The record shows that the gist of the scheme was respondents' holding themselves out as financial planners who would exercise their talents to make the best choices for their

It is not surprising that typical investors are confused about the nature of the services offered by their financial professionals. In survey after survey, consumers have indicated that they do not understand the key distinctions between investment advisers and broker-dealers: their duties, the services they offer, or Consumers attribute their confusion in large part to the brokers' use of titles such as "financial advisor" and "financial consultant." This confusion is exacerbated by advertisements from broker-dealer firms, such as those that claim:

"Our Clients' Interests Always Come First"¹⁰

"Our financial advisors are committed to putting your investing needs, wants and priorities first."¹¹

"We address every dimension of your life and your goals—investments, business, passion and legacy—to develop a plan that's truly personalized for you. It's precisely what you need today, and always. Advice. Beyond investing."¹²

The Commission long cautioned broker-dealer firms to not disguise their merchandizing role. In previous decades the Commission strongly cautioned brokerage firms against the use of titles or other forms or promotion or advertising that might mislead investors. Yet, by permitting broker-dealer firms, via proposed Regulation BI, to advertise that they act in their customer's "best interests," when in fact such is not the case, the Commission has reversed course and now aids broker-dealer firms in their disguises.

C. THE COMMISSION FAILS TO ADEQUATELY ALLEVIATE CONSUMER CONFUSION, BY PERMITTING NON-FIDUCIARY BROKERS TO UTILIZE TITLES THAT RESULT IN FIDUCIARY STATUS UNDER THE COMMON LAW

The Commission itself has long been aware that the public is confused by use of confusing titles, including a thorough study of the issue it commissioned in 2008, undertaken by the RAND Corporation.¹³ Yet, in a

clients from all available securities, when in fact their efforts were directed at liquidating clients' portfolios and utilizing the proceeds and their clients' other assets to purchase securities which would yield respondents the greatest profits, in some instances in complete disregard of their clients' stated investment objectives. This scheme was implemented by, among other things, registrant's advertising and by its training course for salesmen ...

It is abundantly clear from this record that under the guise of comprehensive "financial planning" encompassing the purchase of varied securities, including listed securities, the above respondents induced customers, who were generally inexperienced and unsophisticated, to believe that their best interests would be served by following the investment program designed for them by respondents. In fact, such programs were designed to sell securities that would provide the greatest gain to respondents, rather than to promote the customers' interests; indeed, in some instances, the recommendations were directly contrary to the customers' expressed investment needs and objectives.

In the Matter of Haight & Company, Inc. (Feb. 19, 1972)

¹⁰ The first "Business Principal" of Goldman Sachs, from their web site, retrieved Dec. 22, 2017.

¹¹ Merrill Lynch web site, retrieved Dec. 22, 2017.

¹² UBS web site, retrieved Dec. 22, 2017.

¹³ In 2008 the RAND Study reported: "Even after being presented with fact sheets, [survey] participants were confused by the different titles. They noted that the common job titles for investment advisers and broker-dealers are so similar that people can easily get confused over the type of professional with which they are working." Angela A.

Commission's early 2018 release,¹⁴ the Commission only suggests restrictions on the use of certain titles, but not many others that possess similar meaning in the eyes of consumers.

Separate studies by the Public Investors Arbitration Bar Association (PIABA) released in March 2015 "Major Losses Due to Conflicted Advice: Brokerage Industry Advertising Creates the Illusion of A Fiduciary Duty"¹⁵ and by the Consumer Federation of America released in January 2017 "Financial Advisor or Investment Salesperson: Brokers and Insurers Want to Have it Both ways"¹⁶ show that while many brokerage firms market themselves to the public as trusted 'advisors' or related terms, it is a different story when it comes to defending that position in arbitration hearings. In the context of arbitration proceedings, suddenly the brokers are "just salespersons" and owe the client no fiduciary duty.

In 2012 the Commission Investor Advisor Committee highlighted the problem from inappropriate use of titles, stating: "In addition, many broker-dealers use titles such as financial adviser for their registered representatives and market themselves in ways that highlight the advisory aspect of their services . . . Although they are subtler and more difficult to measure, than the harm that results from outright fraud, these types of harm can nonetheless have a significant impact on investors' financial well-being."¹⁷

The Commission has long recognized that it sets the floor, but not the ceiling, as to the extent of a broker's duties. Brokers, even if they are not required to register as investment advisers pursuant to the Investment Advisers Act of 1940, are often found to be in a fiduciary relationship with their customers through the application of state common law.¹⁸ Furthermore, under state common law, which is not

Hung, Noreen Clancy, Jeff Dominitz, Eric Talley, Claude Berrebi, and Farrukh Suvankulov of the RAND Corporation, "*Investor and Industry Perspectives on Investment Advisers and Broker-Dealers*," at p.111. This Rand Study was sponsored by the United States Securities and Exchange Commission,

¹⁴ Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles, Investment Advisers Act Release No. IA-4888 (April 18, 2018) ("Form CRS Proposal").

¹⁵ <https://piaba.org/system/files/pdfs/PIABA%20Conflicted%20Advice%20Report.pdf>

¹⁶ https://consumerfed.org/wp-content/uploads/2017/01/1-18-17-Advisor-or-Salesperson_Report.pdf

¹⁷ "(Draft) Recommendation of the Investor as Purchaser Subcommittee Broker-Dealer Fiduciary Duty," available at <https://www.sec.gov/spotlight/investor-advisory-committee-2012/fiduciary-duty-recommendation.pdf>.

¹⁸ The SEC's March 1, 2013 release acknowledges that brokers and their registered representatives may possess a fiduciary duty under state common law: "A broker-dealer may have a fiduciary duty under certain circumstances. This duty may arise under state common law, which varies by state. Generally, courts have found that broker-dealers that exercise discretion or control over customer assets, or *have a relationship of trust and confidence with their customers*, are found to owe customers a fiduciary duty similar to that of investment advisers." [*Emphasis added.*]

See also 2011 SEC Staff Study, *supra* n.2, at pp.10-11. "While broker-dealers are generally not subject to a fiduciary duty under the federal securities laws, courts have found broker-dealers to have a fiduciary duty under certain circumstances. Moreover, broker-dealers are subject to statutory, Commission and SRO requirements that are designed to promote business conduct that protects customers from abusive practices, including practices that may be unethical but may not necessarily be fraudulent." It should be noted that the views expressed in the Study were those of the staff and do not necessarily reflect the views of the Commission or the individual Commissioners.

See also A Joint Report of the SEC and the CFTC on Harmonization of Regulation (Oct. 2009), available at <http://www.sec.gov/news/press/2009/cftcjointreport101609.pdf>, stating: "While the statutes and regulations do not uniformly impose fiduciary obligations on a [broker-dealer (BD)], a BD may have a fiduciary duty under certain circumstances, at times under state common law, which varies by state. Generally, BDs that exercise discretion or control over customer assets, or *have a relationship of trust and confidence with their customers*, are found to owe customers a

preempted by the SEC's rule-making activities, it has long been recognized that the use of a title denoting an advisory role is a significant factor in determining that fiduciary status exists:

Koehler, 1985. A U.S. District Court in 1985 held that a fiduciary relationship existed in part because of a defendant's status as financial planner to a client. In *Koehler v. Pulvers*, 614 F. Supp. 829 (USDC, Cal, 1985) the defendant, CSCC, was primarily in the business of real estate syndication, but also in business under the name Creative Financial Planning. As stated in the decision, "The developer defendants obtained investment capital from the public by posing as financial planners ... The financial planners typically had a background in either insurance or real estate sales ... As an alleged financial planning company, CSCC, dba Creative Financial Planners, contacted potential investors by conducting Creative Financial Planning seminars open to the public. Utilizing a slick presentation... CSCC attempted to lure investment capital out of savings accounts, home equity, insurance policies, and other conservative investment vehicles and into the speculative real estate ventures it controlled ... At the seminars, CSCC offered to draft a 'Coordinated Financial Plan' for attendees at little or no charge. Individuals who accepted this offer received recommendations to purchase limited partnership or trust deed interests in CSCC controlled partnerships and project" The court also noted, "Most of the plaintiffs are and were unsophisticated investors. Few had a preexisting relationship with the developer defendants at the time they purchased their securities ... [the investors] relied upon the misrepresentations discussed in detail below. This reliance was reasonable in part because of the developer defendants' purported disinterested financial planner status."

Cunningham (1990). Insurance agents who introduced themselves as "investment counselors or enrollers" and who tailored retirement plans for each person depending on the individual's financial position, and who led the customers to believe that an investment plan was being drafted for each customer according to each customer's needs, was held by a federal court, apply Iowa state common law, to lead to the possible imposition of fiduciary status. *Cunningham vs. PLI Life Insurance Company*, 42 F.Supp.2d 872 (1990).

Mathias (2002). "In the fall of 1985, plaintiff, having recently divorced and relocated to Columbus, Ohio, sought investment advice from Thomas J. Rosser. At the time, Rosser was a licensed salesman for Great Lakes Securities Company and held himself out as a financial advisor ... [T]he evidence established that Rosser was a licensed stockbroker and held himself out as a financial advisor, and that plaintiff was an unsophisticated investor who sought investment advice from Rosser precisely because of his alleged expertise as a broker and investment advisor. Further, Rosser testified that plaintiff had relied upon his experience, knowledge, and expertise in seeking his advice. Therefore, we conclude that plaintiff presented sufficient evidence to establish that she and Rosser were in a fiduciary relationship." *Mathias v. Rosser*, 2002 OH 2531 (OHCA, 2002). The court further noted, that under Ohio law, a fiduciary relationship is "a relationship in which one party to the relationship places a special confidence and trust in the integrity and fidelity of the other party to the relationship, and there is a resulting position of superiority or influence, acquired by virtue of the special trust." *Id.*

Williams (2006). In a case arising from Oregon, a self-employed insurance seller and licensed financial planner took advantage of his position as a financial advisor to gain the trust of an 87-year-old

fiduciary duty similar to that of investment advisers ... State common law imposes fiduciary duties upon persons who make decisions regarding the assets of others. *This law generally holds that a futures professional owes a fiduciary duty to a customer if it is offering personal financial advice.*" *Id.* at pp.9-10. [*Emphasis added.*]

man, Stubbs, convincing the elderly man to grant him a power of attorney, with which the financial planner stole about \$400,000. The court held that the licensed financial planner was employed as a fiduciary, specifically noting that the elderly man relied upon the fiduciary as a financial advisor and estate planner. *U.S. v. Williams*, 441 F.3d 716, 724 (9th Cir. 2006).

Hatleberg (2005). When a bank held out as either an “investment planner,” “financial planner,” or “financial advisor,” the Wisconsin Supreme Court held that a fiduciary duty may arise in such circumstances. *Hatleberg v. Norwest Bank Wisconsin*, 2005 WI 109, 700 N.W.2d 15 (WI, 2005).

Graben (2007). A dual registrant crossed the line in "holding out" as a financial advisor, and in stating that ongoing advice would be provided, and other representations, and in so doing the dual registrant, who sold a variable annuity, and was found to have formed a relationship of trust and confidence with the customers to which fiduciary status attached. "Obviously, when a person such as Hutton is acting as a financial advisor, that role extends well beyond a simple arms'-length business transaction. An unsophisticated investor is necessarily entrusting his funds to one who is representing that he will place the funds in a suitable investment and manage the funds appropriately for the benefit of his investor/entrustor. The relationship goes well beyond a traditional arms'-length business transaction that provides 'mutual benefit' for both parties." *Western Reserve Life Assurance Company of Ohio vs. Graben*, No. 2-05-328-CV (Tex. App. 6/28/2007) (Tex. App., 2007).

The Investment Advisers Act of 1940 is based, in large part, upon the fiduciary principles set forth by state common law. The SEC should not act in a manner that is contrary to state common law, thereby leading broker-dealers and their registered representatives to falsely believe that they will not be held to the fiduciary standard of conduct when they use titles that denote a relationship of trust and confidence. This is especially so since, in private actions brought against broker-dealers, state common law is the basis for such action, as the Investment Advisers Act of 1940 does not include a general private right of action for consumers. The Commission should strive for consistency in the law, and not deviate from the fundamental principles of state common law when there exists no valid reason to do so.

D. THE COMMISSION’S PROPOSED REGULATION BI WOULD PERMIT BROKERS TO DISGUISE THEIR ADVERSARIAL ROLE WITH RESPECT TO THEIR CUSTOMERS.

Those who are in arms-length relationships with their customers should do so openly as adversaries, and should not engage in conduct that would lead to imposition of fiduciary status. Early on, the Commission was quite clear on this point. In its 1941 Annual Report, the U.S. Securities and Exchange Commission observed:

If the transaction is in reality an arm's-length transaction between the securities house and its customer, then the securities house is not subject to fiduciary duty. However, the necessity for a transaction to be really at arm's-length in order to escape fiduciary obligations, has been well stated by the United States Court of Appeals for the District of Columbia in a recently decided case: “[T]he old line should be held fast which marks off the obligation of confidence and conscience from the temptation induced by self-interest. He who would deal at arm's length must

stand at arm's length. And he must do so openly as an adversary, not disguised as confidant and protector. He cannot commingle his trusteeship with merchandizing on his own account...' ”¹⁹

Over five decades ago, the Commission cautioned that broker-dealer advertising “may create an atmosphere of trust and confidence, encouraging full reliance on broker-dealers and their registered representatives as professional advisers in situations where such reliance is not merited, and obscuring the merchandising aspects of the retail securities business ... Where the relationship between the customer and broker is such that the former relies in whole or in part on the advice and recommendations of the latter, the salesman is, in effect, an investment adviser, and some of the aspects of a fiduciary relationship arise between the parties.”²⁰

Yet, with Regulation BI, the Commission proposes to permit broker-dealer firms and their registered representatives represent to their customers that they act in the “best interests” of their clients – when in fact such is not the case – as will be demonstrated in the next section.

E. THE COMMISSION’S SAFE HARBOR HUGE HOLE, AND THE ABILITY OF THE BROKER TO DISCLAIM AWAY ITS OBLIGATIONS, MEANS THAT NO BROKER IS ACTUALLY REQUIRED TO ACT IN THE “BEST INTERESTS” OF THE CUSTOMER

The requirement under “Regulation Best Interests” to actually act in the best interests of a customer is easily avoided, by the express terms of the proposal.

the proposed Reg. Section 240.15l-1 Regulation Best Interest, subsection (a)(2) contains this safe harbor provisions. Some observations about this "safe harbor." First, nothing in the safe harbor [subsection (a)(2)] includes the requirement in section (a)(1) that the recommendation be "without placing the financial or other interest of the broker, dealer, ahead of the interest of the retail customer." In essence, the safe harbor swallows, and eviscerates, the key language of Reg BI.

Second, while the SEC sets out an example of how a higher-cost, and higher-remuneration, fund could not be recommended over a lower-cost one, there is nothing in the actual language of the safe harbor that compels this conclusion - because of the lack of the non-inclusion of the language "without placing the interest of ..." in the safe harbor itself.

Additionally, unlike the fiduciary duty arising under the Advisers Act and state common law, nothing prevents the broker from disclaiming its obligations, nor from seeking the customers to waive their rights. The concepts of waiver and estoppel, which have limited application to a fiduciary relationship, appear to be fully applied here.

In essence, Regulation Best Interests does not impose any substantial obligations on brokers that they don't already possess. All it does is permit brokers to advertise that they act in the “best interest” of their customers, when such is not the case. Brokers would be permitted, under Regulation Best Interests, to engender trust, while not being held to anything close to the bona fiduciary standard of conduct.

¹⁹ *Seventh Annual Report of the Securities and Exchange Commission*, Fiscal Year Ended June 30, 1941, at p. 158, citing *Earll v. Picken* 113 F. 2d 150 (D.C. Ct. App. 1940).

²⁰ 1963 SEC Study, citing various SEC Releases.

F. “BEST INTERESTS” MEANS “FIDUCIARY” !!!

I provide extensive recitations of authority on this point:

1. **The phrase “best interests” (as utilized, in its context, “best interests of the consumer”) is a phrase that has been reserved under the law for a fiduciary-client relationship, not a salesperson-customer relationship. The proposed modifications incorporating such a “best interests” standard without the imposition of bona fide fiduciary obligations is wholly inappropriate.**
 - 1.1. “Acting in One’s Best Interests” is the Phrase Utilized to Describe Fiduciary Obligations to Lay Persons in Language They Better Understand.
 - 1.1.1. The phrase “act in the best interests of the client” is used to explain, in language a non-lawyer would understand, the core aspect of the fiduciary duty of loyalty as well as elements of the fiduciary obligation of due care and utmost good faith.
 - 1.1.1.1. Lay persons would be misled into relying upon an insurance producer who is selling particular products, even though the lay person (consumer) is not afforded the protections of a bona fide fiduciary standard. Lay persons understand the term “best interests” to apply to advisers whom they can trust.²¹
 - 1.1.1.2. The regulatory permission effectively granted to brokers and their registered representatives (salespersons) under the proposed Regulation BI - to utilize a phrase such as “I am bound by regulation to act in your ‘best interest’s” – when there is no actual requirement to adhere to a fiduciary obligation and the relationship remains one in which the customer does not receive the protections of fiduciary law - would cause tremendous harm to consumers.
 - 1.1.1.3. In essence, consumers would believe that they could rely upon an insurance salesperson’s advice, given the regulatory approval of the use of the term “best interests” by salespersons, and such reliance by consumers would certainly be justified in such a circumstance. In essence, consumers would be lulled into thinking that they could rely upon the recommendations provided, when in fact such is not the case. As a result, such consumers would seldom undertake the efforts they should to protect their

²¹ It has long been a concern that lay consumers often place trust in non-fiduciary actors in financial services, even when such trust is not merited, due in major part to how broker-dealer firms and their registered representatives now hold themselves out and promote themselves, and the increased scope of the advice which they provided. *See Recommendation of the Investor as Purchaser Subcommittee: Broker-Dealer Fiduciary Duty (U.S. Securities and Exchange Commission, 2012):* “Because federal regulations have not kept pace with changes in business practice, broker-dealers and investment advisers are subject to different legal standards when they offer advisory services. Those legal standards – a suitability standard for broker-dealers and a fiduciary duty for investment advisers – afford different levels of protection to the investors who rely on those services. Key differences include the requirements that investment advisers, as fiduciaries, act in the best interests of their clients and appropriately manage and fully disclose conflicts of interest that could bias their recommendations. Investors typically make no distinction between broker-dealers and investment advisers, and most are unaware of the different legal standards that apply to their advice and recommendations. Although many investors don’t understand the meaning of “fiduciary duty,” or know whether it or suitability represents the higher standard, *investors generally treat their relationships with both broker-dealers and investment advisers as relationships of trust and expect that the recommendations they receive will be in their best interests*” [Emphasis added.]

own interests, such as seeking out additional knowledge about the annuities recommended or seeking second opinions or alternative proposals from other insurance producers.

- 1.1.1.4. Consumers should not be forced to investigate, in order to discern whether those who hold themselves out as acting in their best interests, as fiduciaries, actually do so.²²
- 1.1.1.5. Simply put, because under the proposed model regulation an insurance producer could state that she or he acts in the “best interests” of the customer, when in fact no duty of loyalty nor substantially enhanced duty of due care (to the level of a true fiduciary) exists, consumers will have reasonably placed their trust and confidence in the insurance producer even though, in effect, an arms-length relationship still exists.
- 1.1.2. The term “best interests” has an established legal meaning, which COMMISSION should not seek to alter.
 - 1.1.2.1. *Black's Law Dictionary* (10th ed. 2014) defines a fiduciary duty as "a duty to act with the highest degree of honesty and loyalty toward another person and in the *best interest* of the other person" (*emphasis added*).
 - 1.1.2.2. The meaning of “best interests” as indicative of the fiduciary relationship is universal in other common law countries. As the joint judgment of McHugh, Gummow, Hayne and Callinan JJ explained in *Pilmer v Duke Group*, a decision from Australia, it is the “pledge” (undertaking) by one party to act in the best interests of the other which makes fiduciary relationships distinct from other relationships.²³
 - 1.1.2.3. The Commission’s proposal to utilize the term “best interests,” short of imposing a bona fide fiduciary obligation, would undermine centuries of legal precedent.
 - 1.1.2.4. The Commission’s proposal would therefore fail to heed the warnings of the late Justice Benjamin Cardoza, who so famously wrote: “Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the ‘disintegrating erosion’ of particular exceptions [citation omitted]. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.”²⁴

²² As the SEC staff stated in its 2011 Study, “Retail investors are relying on their financial professional to assist them with some of the most important decisions of their lives. Investors have a reasonable expectation that the advice that they are receiving is in their best interest. They should not have to parse through legal distinctions to determine whether the advice they receive was provided in accordance with their expectations.” SEC Staff, Study on Investment Advisers and Broker-Dealers, As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, January 2011 (available here: <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>).

²³ *Pilmer v The Duke Group (in Liq)* (2001) 207 CLR 165, [70]-[71]. See also *Norberg v Wynrib*, [1992] 2 S.C.R. 226 at 230 [Canada], per McLachlin J: “The essence of a fiduciary relationship... is that one party exercises power on behalf of another and pledges himself or herself to act in the best interests of the other.”

²⁴ *Meinhard vs. Salmon*, 164 N.E. 545 (N.Y. 1928).

1.1.2.5. The Commission’s proposal, if adopted, would change the definition of “best interests” – representing a significant erosion of an established definition that is currently understood by jurists, financial advisors, and consumers to refer to the key legal obligations of a fiduciary.

1.1.2.5.1. Such a change in the definition of “best interests” could result in an erosion of the duties owed to those who are fiduciaries in other contexts – such as those who undertake to care for incompetent or dependent people (such as children or infants), attorneys who represent the important legal interests of their clients in a variety of contexts, and the duties of trustees toward their beneficiaries.

1.1.2.5.2. The Commission should not seek to degrade the long-established obligations of bona fide fiduciaries by ignoring centuries of legal understanding, and lay understanding, of the term “best interests.”

1.2. Understanding the Two Different Forms of Commercial Relationships Under the Law: “Who’s On Top”? There exist two fundamentally different forms of commercial relationship in the law: the salesperson-customer relationship, and the fiduciary-entrustor (or fiduciary-client) relationship. These relationships are completely different under the law, and stark distinctions exist between the legal duties of the various parties in these relationships. Understanding fiduciary duties begins with an understanding of the two general types of relationships between product and service providers and their customers or clients under the law – “arms-length relationships” and “fiduciary relationships.”²⁵

1.2.1. Even with enhanced safeguards afforded to consumers such as enhanced disclosure obligations, the arms-length relationship of the parties involved in the sale of an investment or insurance product can still be described as:

PRODUCT MANUFACTURER(S)

⇓

MANUFACTURERS’ (SALES) REPRESENTATIVES

⇓

CUSTOMER

1.2.2. The fiduciary relationship is altogether different. The fiduciary acts as a “purchaser’s representative” – *i.e.*, on behalf of the client. The fiduciary “steps into the shoes of the client” and acts as if the client would act for himself/herself – but armed with the knowledge, skill, experience and hence expertise that the fiduciary possesses and is required

²⁵ “The legal system provides for only two levels of trust and their differentiation is necessary for them to be useful tools for parties setting up relationships ... In essence, legal systems provide only two levels of loyalty between contracting parties, arm's-length and fiduciary relationships. The difference in the degree of trust that the two levels of loyalty entitle the parties is dramatic. Fiduciary relations impose a pure duty of loyalty, according to which the fiduciary must place the interests of his employer before his own. Arm's-length relations, by contrast, allow exploitation within the parameters of good faith.” Georgakopoulos, Nicholas L., “Meinhard v. Salmon and the Economics of Honor” (April 1998, revised Feb. 8, 1999). Available at SSRN: <http://ssrn.com/abstract=81788> or DOI: 10.2139/ssrn.81788.

to apply prior to making any recommendations to the client. The fiduciary relationship can be modeled as follows:

CLIENT



FIDUCIARY (PURCHASER'S OR CLIENT'S REPRESENTATIVE)



PRODUCT MANUFACTURERS

1.2.3. Enhancements to required disclosures do not turn those in arms-length relationships into fiduciary actors. While disclosures can be an important consumer protection, much academic research has revealed the limits to their effectiveness. Because disclosures are so often ineffective as a means of protecting consumers, the law applies the protections of the fiduciary relationship in situations where public policy so dictates.

1.3. Arms-Length Relationships: Actual Fraud is Prohibited; Additional Obligations May Be Imposed by Law Short of Fiduciary Obligations. “Arms-length” relationships apply to the vast majority of service provider–customer engagements.²⁶ In other words, non-fiduciaries who contract with each other can engage in “conduct permissible in a workaday world for those acting at arm's length.”²⁷

1.3.1. In arms-length relationships, the doctrine of *caveat emptor*²⁸ generally applies,²⁹ although there are many exceptions made to this doctrine in which enhanced disclosure obligations arise, mandated contractual forms exist, or even certain products are prohibited. For example,

²⁶ See, for example, *Hartman v. McInnis*, No. 2006-CA-00641-SCT (Miss. 11/29/2007) ([O]rdinarily a bank does not owe a fiduciary duty to its debtors and obligors under the UCC ... the power to foreclose on a security interest does not, without more, create a fiduciary relationship ... a mortgagee-mortgagor relationship is not a fiduciary one as a matter of law.”). “[T]he significant weight of authority holds that franchise agreements do not give rise to fiduciary ... relationships between the parties.” *GNC Franchising, Inc. v. O'Brien*, 443 F.Supp.2d 737, 755 (W.D. Pa., 2006).

²⁷ *Meinhard v Salmon*, 249 NY 458, 464 (N.Y. 1928).

²⁸ *Caveat emptor* is Latin for ‘Let the buyer beware.’ In its purest form at common law, in the absence of fraud, misrepresentation or active concealment, the seller is under no duty to disclose any defect; it therefore provides a safe harbor to a seller to not to disclose any information to a buyer. See Alex M. Johnson, Jr., “An Economic Analysis Of The Duty To Disclose Information: Lessons Learned From The Caveat Emptor Doctrine” (2007), available at <http://law.bepress.com/cgi/viewcontent.cgi?article=9154&context=expresso>. It means that a customer should be cautious and alert to the possibility of being cheated. The doctrine supports the idea that buyers take responsibility for the condition of the items they purchase and should examine them before purchase. This is especially true for items that are not covered under any warranty. See, e.g. *SEC v. Zandford*, 535 U.S. 813 (2002).

²⁹ “When parties deal at arm's length the doctrine of *caveat emptor* applies, but the moment that the vendor makes a false statement of fact, and the falsity is not palpable to the purchaser, he has an undoubted right to implicitly rely upon it. That would indeed be a strange rule of law which, when the seller has successfully entrapped his victim by false statements, and was called to account in a court of justice for his deceit, would permit him to escape by urging the folly of his dupe was not suspecting that he (the seller) was a knave.” *Holcomb v. Zinke*, 365 N.W.2d 507, 511 (N.D., 1985).

even state common law compels affirmative disclosure of adverse material facts in diverse contexts.³⁰

- 1.3.2. In arms-length, commercial relationships, the level of trust or confidence reposed by the customer in the other party is not exceptional. “Mere subjective trust does not transform arms-length dealing into a fiduciary relationship.”³¹ “Absent express agreement of the parties³² or extraordinary circumstances, however, parties dealing at arms-length in a commercial transaction lack the requisite level of trust or confidence between them necessary to give rise to a fiduciary obligation.”³³ Ordinary “buyer-seller relationships” do not give rise to the imposition of fiduciary duties upon the seller.³⁴
- 1.3.3. Yet, it must be recognized that *commercial good faith* is always required in contract performance. Actors in arms-length relationships are always subject to the requirement of “mere good faith and fair dealing”³⁵ in the performance of their obligations; this doctrine is

³⁰ It is well settled that fraud may occur without the making of a false statement. *Dvorak v. Dvorak*, 329 N.W.2d 868 (N.D.1983). The suppression of a material fact, which a party is bound in good faith to disclose, is equivalent to a false representation. *Verry v. Murphy*, 163 N.W.2d 721 (N.D.1969).

³¹ *Exxon Corp. v. Breezevale Ltd.*, 82 S.W.3d 429 (Tex. App., 2002).

³² *Pension Committee v. Banc of America Securities*, 592 F.Supp.2d 608, 624 (S.D.N.Y., 2009) (“a fiduciary relationship may arise where the parties to a contract specifically agree to such a relationship”).

³³ *Pension Committee v. Banc of America Securities*, 592 F.Supp.2d 608, 624 (S.D.N.Y., 2009) (“no fiduciary duties arise where parties deal at arm’s length in conventional business transaction”); *Henneberry v. Sumitomo Corp. of America*, 415 F.Supp.2d 423, 460 (S.D.N.Y., 2006), citing *Nat’l Westminster Bank, U.S.A. v. Ross*, 130 B.R. 656, 679 (S.D.N.Y.1991) (“Where parties deal at arms length in a commercial transaction, no relation of confidence or trust sufficient to find the existence of a fiduciary relationship will arise absent extraordinary circumstances.” (citing, *inter alia*, *Grumman Allied Indus., Inc. v. Rohr Indus., Inc.*, 748 F.2d 729, 738-39 (2d Cir.1984); *Aaron Ferer & Sons Ltd. v. Chase Manhattan Bank, N.A.*, 731 F.2d 112, 122 (2d Cir. 1984))), *aff’d*, *Yaeger v. Nat’l Westminster*, 962 F.2d 1 (2d Cir.1992) (table); *Beneficial Commercial Corp. v. Murray Glick Datsun, Inc.*, 601 F.Supp. 770, 772 (S.D.N.Y. 1985) (“[C]ourts have rejected the proposition that a fiduciary relationship can arise between parties to a business transaction.” (citing *Grumman Allied Indus., Inc.*, 748 F.2d at 738-39; *Wilson-Rich v. Don Aux Assocs., Inc.*, 524 F.Supp. 1226, 1234 (S.D.N.Y.1981); *duPont v. Perot*, 59 F.R.D. 404, 409 (S.D.N.Y.1973))); *WIT Holding Corp. v. Klein*, 282 A.D.2d 527, 724 N.Y.S.2d 66, 68 (App.Div.2001) (“Under these circumstances, where the parties were involved in an arms-length business transaction involving the transfer of stocks, and where all were sophisticated business people, the plaintiff’s cause of action to recover damages for breach of fiduciary duty should have been dismissed.”).

³⁴ *In re Prudential Ins. Co. of America Sales Prac.*, 975 F.Supp. 584 (D.N.J., 1996), where, in a case involving sales by life insurance agents of variable appreciable life insurance products as “investment plans,” the court stated: “An essential feature and consequence of a fiduciary relationship is that the fiduciary becomes bound to act in the interests of her beneficiary and not of herself. Obviously, this dynamic does not inhere in the ordinary buyer-seller relationship. Thus, ‘the efforts of commercial sellers — even those with superior bargaining power — to profit from the trust of consumers is not enough to create a fiduciary duty. If it were, the law of fiduciary duty would largely displace both the tort of fraud and much of the Commercial Code.’ *Committee on Children’s Television, Inc., v. General Foods Corp.*, 35 Cal.3d 197, 221, 197 Cal.Rptr. 783, 789, 673 P.2d 660, 675 (1983) (en banc).” *In re Prudential Ins. Co. of America Sales Prac.* At 616.

³⁵ See *GNC Franchising, Inc. v. O’Brien*, 443 F.Supp.2d 737, 755 (W.D. Pa., 2006) (“A party bound by a fiduciary duty must advance the interests of the *cestui que* trust above its own and act scrupulously in the other’s interests. Imposition of this degree of duty—*i.e.*, selfless service as opposed to merely good faith and fair dealing—would generally be inapplicable as between parties to a commercial relationship knowingly entered into for each party’s own profit”).

fundamental to all commercial transactions.³⁶ Good faith requires that each party perform their respective obligations and enforce their rights honestly and fairly.³⁷

- 1.3.4. While there is no general duty to disclose material facts in arms-length transactions, actual or “common law” fraud is prohibited in the formation of commercial relationships. There is generally no duty to undertake full disclosure of material facts in the negotiation of commercial contracts,³⁸ except where one party’s superior knowledge renders non-

In arms-length relationships, the burden of proof of lack of fair dealing rests on the person alleging that the other party acted in such manner. This contrasts with the burden of proof where a fiduciary relationship exists, where the burden of proof of fair dealing rests with the fiduciary. *See ABN Amro Mortgage Group, Inc. v. Pristine Mortgage, LLC*, No. CV 04-4005389 (CT 9/8/2005) (CT, 2005) (“The significance of the establishment of a fiduciary relationship is twofold. First, the burden of proving fair dealing shifts to the fiduciary. Secondly, the standard of proof for establishing fair dealing is not the ordinary standard of fair preponderance of evidence but requires proof of clear and convincing evidence.”)

³⁶ The doctrine of good faith requires that the parties also perform their respective obligations and enforce their rights honestly and fairly. *See* Restatement (Second) Contracts (1981) at §205, “Duty of Good Faith and Fair Dealing,” stating: “Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.” The *Comment* to this section adds: “Good faith is defined in Uniform Commercial Code § 1-201(19) as ‘honesty in fact in the conduct or transaction concerned.’ ‘In the case of a merchant’ Uniform Commercial Code §2-103(1)(b) provides that good faith means ‘honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.’ The phrase ‘good faith’ is used in a variety of contexts, and its meaning varies somewhat with the context. Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving ‘bad faith’ because they violate community standards of decency, fairness or reasonableness. Failure to abide by the duty of good faith may constitute fraud (in the event of intentional misrepresentation) or breach of contract.”

³⁷ For example, the Uniform Commercial Code, adopted by every state except Louisiana, explicitly imposes a good faith obligation on the performance and enforcement of every contract falling within its scope. UCC § 1-304, as amended (2003). Essentially, the Restatement of Contracts adopts the view that “bad faith in performance” is a violation of the good faith obligation. As stated by Professor Emily S.H. Hough: “The subcategories of bad faith in performance further delineated by Summers include ‘evasion of the spirit of the deal,’ ‘lack of diligence and slacking off,’ ‘willfully rendering only ‘substantial performance,’ ‘abuse of power to determine compliance,’ and ‘interfering with or failing to cooperate in the other party’s performance.’” All of these subcategories contemplate cases in which judges would feel comfortable using their discretionary and equitable powers to find a breach of good faith where the express language of the contract might not otherwise support a claim for breach of contract.” Hough, Emily, “The Doctrine of Good Faith in Contract Law: A (Nearly) Empty Vessel?” *Utah Law Review*, 2005. Available at SSRN: <http://ssrn.com/abstract=622982>.

³⁸ *See Southern Intermodal Logistics, Inc. v. Smith & Kelly Co.*, 190 Ga.App. 584, 379 S.E.2d 612, 613-4 (1989) (“While concealment of material facts may amount to fraud when the concealment is of intrinsic qualities the other party could not discover by the exercise of ordinary care ... in an arms-length business or contractual relationship there is no obligation to disclose information which is equally available to both parties”).

disclosure of an essential fact inherently unfair³⁹ or a “special relationship” exists.⁴⁰ Instead, actors in commercial relationships generally possess a duty to undertake diligent inquiry in order to ascertain facts.⁴¹ However, if disclosures are undertaken by a party, the statements made must be truthful and complete⁴² or actual fraud⁴³, also called “common law fraud,” exists. And, while commercial good faith does not automatically extend to the area of contract negotiations, misrepresentations made during the formation of a contract may constitute either actual fraud or breach of contract.⁴⁴ To put it much more simply, don’t lie, cheat, deceive or steal – even in commercial arms-length relationships.

³⁹ *Henneberry v. Sumitomo Corp. of America*, 415 F.Supp.2d 423 (S.D.N.Y., 2006), stating: “Even absent the existence of a fiduciary relationship, however, a party’s duty to disclose a material fact to another party it is negotiating with is triggered where ‘one party possesses superior knowledge, not readily available to the other, and knows that the other is acting on the basis of mistaken knowledge.’ *Grumman Allied Indus., Inc.*, 748 F.2d at 739 (quoting *Aaron Ferer & Sons Ltd.*, 731 F.2d at 123; *Jana L. v. W. 129th St. Realty Corp.*, 22 A.D.3d 274, 802 N.Y.S.2d 132, 134 (App.Div.2005) (‘It is well established that, absent a fiduciary relationship between the parties, a duty to disclose arises only under the ‘special facts’ doctrine ‘where one party’s superior knowledge of essential facts renders a transaction without disclosure inherently unfair.’ (quoting *Swersky v. Dreyer & Traub*, 219 A.D.2d 321, 643 N.Y.S.2d 33, 37 (App.Div. 1996).’ *Henneberry* at 461.

⁴⁰ *See Giles v. General Motors Acceptance Corp.*, 494 F.3d 865, 881 (9th Cir., 2007) (“Nevada also recognizes “special relationships” giving rise to a duty to disclose, such that ‘[n]ondisclosure . . . become[s] the equivalent of fraudulent concealment.’ *Mackintosh v. Jack Matthews & Co.*, 109 Nev. 628, 855 P.2d 549, 553 (1993). In order to prove the existence of a special relationship, a party must show that (1) ‘the conditions would cause a reasonable person to impart special confidence’ and (2) the trusted party reasonably should have known of that confidence. *Mackintosh v. Cal. Fed. Sav. & Loan Ass’n*, 113 Nev. 393, 935 P.2d 1154, 1160 (1997) (per curiam). ‘[T]he existence of the special relationship is a factual question’ *Id.*)

⁴¹ *See Burger King Corp. v. Austin*, 805 F.Supp. 1007, 1019 (S.D. Fla., 1992) (“Florida law additionally charges a claimant with knowledge of all facts that he could have learned through diligent inquiry ... In absence of a fiduciary relationship, mere nondisclosure of material facts in an arm’s length transaction is ordinarily not actionable misrepresentation unless some artifice or trick has been employed to prevent the representee from making further independent inquiry, though non-disclosure of material facts may be fraudulent where the other party does not have an equal opportunity to become appraised of the facts.”), citing *Taylor v. American Honda Motor Co.*, 555 F.Supp. 59, 64 (M.D.Fla.1982).

⁴² *See Playboy Enterprises v. Editorial Caballero*, 202 S.W.3d 250, 260 (Tex. App., 2006), stating: “In addition to situations where there is a fiduciary or confidential relationship ... a duty to speak may arise in an arms-length transaction in at least three other situations: (1) when one voluntarily discloses information, he has a duty to disclose the whole truth; (2) when one makes a representation, he has a duty to disclose new information when the new information makes the earlier representation misleading or untrue; and (3) when one makes a partial disclosure and conveys a false impression, he has the duty to speak.”

⁴³ “Actual fraud is where one person causes pecuniary injury to another by intentionally misrepresenting or concealing a material fact which from their mutual position he was bound to explain or disclose.” Charles Sweet, *A Dictionary of English Law* (1883).

⁴⁴ Waller, Spencer Weber and Brady, Jillian G., “Consumer Protection in the United States: An Overview; Strengthening the Consumer Protection Regime” (2007), available at SSRN: <http://ssrn.com/abstract=1000226>. Private actions alleging actual fraud form an important, though often expensive and difficult, avenue for protection of the rights of a contracting party. “A consumer may file a lawsuit for deceit or fraud when a vendor intentionally conceals a material fact or makes a false representation of a material fact, knows that the representation is false, and meant to induce the consumer to act based on the misrepresentation. In order for the consumer to be successful in court, a plaintiff must also reasonably rely on the misrepresentation and suffer damage as a result of the reliance. Deceit can occur when a vendor makes a direct false statement, or when a misrepresentation is achieved through

- 1.4. No fiduciary obligations exist in most arms-length relationships. “An arms-length relationship can support no implied-in-law fiduciary obligations.”⁴⁵
 - 1.4.1. The standard of conduct expected of the actors in arms-length relationships has been described by the courts as the “morals of the marketplace.”⁴⁶
 - 1.4.2. In contrast, the fiduciary obligation is much more than the duties found for actors in arms-length relationships. Professor Deborah DeMott asserts that “[t]he fiduciary’s duties go beyond mere fairness and honesty; they oblige him to act to further the beneficiary’s best interests.”⁴⁷
- 1.5. Fiduciary-entrustor (i.e., fiduciary-client) relationships are completely different from arms-length relationships; the fiduciary represents not the seller of a product, but rather the client alone. The other type of relationship is the fiduciary-entrustor relationship. In this type of relationship the provider of services (either management of assets, or the provision of advice) adopts a wholly different role. The fiduciary becomes bound by fiduciary duties of due care, loyalty and utmost good faith to the entrustor (the “client” in our context of investment or financial advice). The fiduciary, in essence, “steps into the shoes” of the client, and makes the decisions (or provides the advice) as if the fiduciary was the client. In other words, the fiduciary is bound to act in the sole or best interests of the client.
- 1.6. Understanding the true nature of the fiduciary-client relationship.

silence, concealment, half-truths, or ambiguity about a good. While misrepresentation of product facts may bring legal action, mere puffery and sales representative opinions are generally not subject to lawsuits for deceit.” *Id.* at p. 13.

⁴⁵ *Marine, Inc. v. Brunswick Corporation*, No. 07-13907 Non-Argument Calendar (11th Cir. 5/14/2008) (11th Cir., 2008), at p.5; see *Taylor Woodrow Homes Florida, Inc. v. 4/46-A Corp.*, 850 So.2d 536, 541 Fla. 5th DCA 2003 (“When the parties are dealing at arm’s length, a fiduciary relationship does not exist because there is no duty imposed on either party to protect or benefit the other.”). See also *Greenberg v. Chrust*, 198 F.Supp.2d 578, 585 (S.D.N.Y., 2002) (“parties to arms length commercial contracts do not owe each other a fiduciary obligation”).

⁴⁶ *In re Auto Specialties Mfg. Co.*, 153 B.R. 457, 488 (Bankr. W.D. Mich., 1993) (Courts have described the standard of conduct to which a non-fiduciary will be held in the vernacular as the ‘morals of the marketplace’”).

⁴⁷ Deborah DeMott, “Beyond Metaphor: An Analysis of Fiduciary Obligation” (1988) *Duke Law Journal* 879 at 888.

- 1.6.1. The fiduciary standard of conduct flows from the requirement of the fiduciary “to adopt the principal’s goals, objectives, or ends.”⁴⁸ “It is what makes fiduciary law unique and separates fiduciaries from other service providers.”⁴⁹ As Professor Arthur Laby explained:

Some even use the phrase ‘alter ego’ to reference the fiduciary norm. This personalizes the duty in a particular way. The fiduciary must appropriate the objectives, goals, or ends of another and then act on the basis of what the fiduciary believes will accomplish them – a happy marriage of the principal’s ends and the fiduciary’s expertise. The fiduciary does not eliminate its own legal personality, rather it must consider the principal’s delegation of authority to the fiduciary from the perspective of fidelity to the principal’s objectives as the fiduciary understands them.⁵⁰

As further explained by Professor Laby, “What generally sets the fiduciary apart from other agents or service providers is a core duty, when acting on the principal’s behalf, to adopt the objectives or ends of the principal as the fiduciary’s own.”⁵¹

- 1.6.2. In contrast to arms-length relationships, the law imposes upon one party to some relationships the status of a fiduciary. This form of relationship is called the “fiduciary relationship” or “fiducial relationship.” One upon whom fiduciary duties are imposed is known as the “fiduciary” and is said to possess “fiduciary status.” The fiduciary standard of conduct is consistently described by the courts as the “highest standard of duty imposed by law.”⁵²

⁴⁸ A fiduciary is “a person having a duty, created by his undertaking, to act primarily for the benefit of another in matters connected with his undertaking.” RESTATEMENT (2^D) AGENCY § 13 comment (a) (1958). “[T]he general fiduciary principle requires that the agent subordinate the agent’s interests to those of the principal and place the principal’s interests first as to matters connected with the agency relationship.” RESTATEMENT (3^D) AGENCY § 8.01 cmt. b (2007). See also Laby, Arthur B., “The Fiduciary Obligation as the Adoption of Ends,” Buffalo L. Rev 99, 103 (2008), available at available at: <http://ssrn.com/abstract=1124722>. See also *Varity Corp. v. Howe*, 516 U.S. 489, 116 S.Ct. 1065, 134 L.Ed.2d 130 (1996), in which the U.S. Supreme Court, applying ERISA, stated that: “There is more to plan (or trust) administration than simply complying with the specific duties imposed by the plan documents or statutory regime; it also includes the activities that are “ordinary and natural means” of achieving the “objective” of the plan. Bogert & Bogert, supra, § 551, at 41-52. Indeed, the primary function of the fiduciary duty is to constrain the exercise of discretionary powers which are controlled by no other specific duty imposed by the trust instrument or the legal regime. If the fiduciary duty applied to nothing more than activities already controlled by other specific legal duties, it would serve no purpose.” *Id.* (Emphasis added.)

⁴⁹ Laby, supra n.65, at 130.

⁵⁰ Laby, supra n.65, at 135.

⁵¹ Arthur B. Laby, *SEC v. Capital Gains Research Bureau and the Investment Advisers Act Of 1940*, 91 Boston Univ. L.Rev. 1051, 1055 (2011).

⁵² See, generally BLACK'S LAW DICTIONARY 523 (7th ed. 1999) (“A duty of utmost good faith, trust, confidence, and candor owed by a fiduciary (such as a lawyer or corporate officer) to the beneficiary (such as a lawyer's client or a shareholder); a duty to act with the highest degree of honesty and loyalty toward another person and in the best interests of the other person (such as the duty that one partner owes to another.); also see *F.D.I.C. v. Stahl*, 854 F.Supp. 1565, 1571 (S.D. Fla., 1994) (“Fiduciary duty, the highest standard of duty implied by law, is the duty to act for someone else's benefit, while subordinating one's personal interest to that of the other person); and see *Perez v. Pappas*, 98 Wash.2d 835, 659 P.2d 475, 479 (1983) (“Under Washington law, it is well established that ‘the attorney-client relationship is a fiduciary one as a matter of law and thus the attorney owes the highest duty to the client.’”),

- 1.6.3. The term "fiduciary" comes to us from Roman law, and means "a person holding the character of a trustee, or a character analogous of a trustee, in respect to the trust and confidence involved in it and the scrupulous good faith and candor which it requires."⁵³ Indeed, the Latin root of the word fiduciary – *fiduciarius* – means one in whom trust – *fiducia* – reposes. Legal usage in many jurisdictions also developed an overlay – an implication of a particular relationship of confidence between the fiduciary and those who had placed their trust in that person.
- 1.6.4. At the beginning of the nineteenth century, in *Gibson*, 31 Eng. Rep. 1044 (1801), the court, while explaining the decision to rescind the sale of an annuity by an attorney to his client, announced that “[one] who bargains in matter of advantage with a person placing confidence in him is bound to sh[o]w, that a reasonable use has been made of that confidence; a rule applying to trustees, attorneys or anyone else.” The courts eventually settled on “fiduciary” to denominate relationships of trust and confidence and denominated the doctrine (applied in *Gibson*) regulating these confidential relationships as “constructive fraud.” By the mid-nineteenth century, the doctrine of constructive fraud was said to arise from some peculiar confidential or fiduciary relation between the parties.
- 1.6.5. More recently, Justice Philip Talmadge of the State of Washington Supreme Court summarized the core aspects of current fiduciary relationships:
- A fiduciary relationship is a relationship of trust, which necessarily involves vulnerability for the party reposing trust in another. One's guard is down. One is trusting another to take actions on one's behalf. Under such circumstances, to violate a trust is to violate grossly the expectations of the person reposing the trust. Because of this, the law creates a special status for fiduciaries, imposing duties of loyalty, care, and full disclosure upon them. One can call this the fiduciary principle.⁵⁴
- 1.6.6. A breach of fiduciary duty constitutes “constructive fraud” under state common law.
- 1.6.6.1. To prove a breach of fiduciary duty, a plaintiff must show that he or she and the defendant had a fiduciary relationship, that the defendant breached its fiduciary duty to the plaintiff, and that this resulted in an injury to the plaintiff or a benefit to the defendant.
- 1.6.6.2. For example, in fiduciary relationships the failure to disclose material facts while seeking a release has been held to be actionable as fraudulent concealment. *See, e.g., Pacelli Bros. Transp. v. Pacelli*, 456 A.2d 325, 328 (Conn. 1982) (“the intentional withholding of information for the purpose of inducing action has been regarded ... as equivalent to a fraudulent misrepresentation.”); *Rosebud Sioux Tribe v. Strain*, 432 N.W.

cited by Bertelsen v. Harris, 537 F.3d 1047 (9th Cir., 2008); also see *Donovan v. Bierwirth*, 680 F. 2d 262, 272, n.8 (2nd Cir., 1982) (fiduciary duties are the “highest known to law”).

⁵³ BLACK'S LAW DICTIONARY, 5th Edition (1979)].

⁵⁴ *Von Noy v. State Farm Mutual Automobile Insurance Company*, 2001 WA 80 (WA, 2001) (J. Talmadge, concurring opinion).

2d 259, 263 (S.D. 1988) (“The mere silence by one under such a [fiduciary] duty to disclose is fraudulent concealment.”) (*Ibid.*)

- 1.6.6.3. Why does “fraud” occur in this context, where there is not an overt misrepresentation of a fact, but only an omission? “Where a fiduciary relationship exists, facts which ordinarily require investigation may not incite suspicion (*see, e.g., Bennett v. Hibernia Bank*, 164 Cal.App.3d 202, 47 Cal.2d 540, 560, 305 P.2d 20 (1956), and do not give rise to a duty of inquiry (*id.*, at p. 563, 305 P.2d 20). Where there is a fiduciary relationship, the usual duty of diligence to discover facts does not exist. *United States Liab. Ins. Co. v. Haidinger-Hayes, Inc.*, 1 Cal.3d 586, 598, 83 Cal.Rptr. 418, 463 P.2d 770 (1970)’ *Hobbs v. Bateman Eichler, Hill Richards, Inc.*, 210 Cal.Rptr. 387, 164 Cal.App.3d 174 (Cal. App. 2 Dist., 1974).
- 1.6.6.4. It is not necessary for the plaintiff to prove causation to prevail on claims of certain breaches of fiduciary duty. It is the agent’s disloyalty, not any resulting harm, that violates the fiduciary relationship.
- 1.6.7. “There is a crucial distinction between surrendering control of one's affairs to a fiduciary or confidant or party in a position to exercise undue influence and entering an arms length commercial agreement, however important its performance may be to the success of one's business.”⁵⁵ The “fiduciary relationship” is distinct from arms-length relationships, as those whom the law classifies as fiduciaries must carry on their dealings with beneficiaries at a level high above ordinary commercial standards.
- 1.6.8. Perhaps the most famous judicial expression of fiduciary duties is Justice Cardozo's famous lines expressing a lofty vision of the duties owed by fiduciaries. “Generations of corporate lawyers have been schooled in its memorable language finding broad fiduciary obligations on managers of other peoples' money.”⁵⁶

Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then

⁵⁵ *Ettol, Inc. v. Elias/Savion Advertising, Inc.*, 811 A.2d 10, 23 (Pa. Super. Ct., 2002), stating: “Most commercial contracts for professional services involve one party relying on the other party's superior skill or expertise in providing that particular service. Indeed, if a party did not believe that the professional possessed specialized expertise worthy of trust, the contract would most likely never take place. This does not mean, however, that a fiduciary relationship arises merely because one party relies on and pays for the specialized skill or expertise of the other party. Otherwise, a fiduciary relationship would arise whenever one party had any marginally greater level of skill and expertise in a particular area than another party. Rather, the critical question is whether the relationship goes beyond mere reliance on superior skill, and into a relationship characterized by "overmastering influence" on one side or "weakness, dependence, or trust, justifiably reposed" on the other side. *Basile v. H & R Block*, 777 A.2d 95, 101 (Pa.Super.2001). A confidential relationship is marked by such a disparity in position that the inferior party places complete trust in the superior party's advice and seeks no other counsel, so as to give rise to a potential abuse of power.” *Id.*

⁵⁶ Georgakopoulos, Nicholas L., *Meinhard v. Salmon and the Economics of Honor*(April 1998). Available at SSRN: <http://ssrn.com/abstract=81788> or DOI: 10.2139/ssrn.81788.

the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions [citation omitted]. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.⁵⁷

1.6.9. As Professor Langbein observed, "Courts have boasted of their "stubbornness and inflexibility," their "[u]ncompromising rigidity," in applying the sole interest rule."⁵⁸

1.7. Advice providers are often fiduciaries. As Professor Arthur Laby notes, "Historically, providing advice has given rise to a fiduciary duty owed to the recipient of the advice. Both the *Restatement (First)* and *Restatement (Second) of Torts* state, "[a] fiduciary relation exists between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation" [citing *Restatement (Second) Of Torts* § 874 cmt. a (1979) (citation omitted) (*emphasis added*); *Restatement (First) Of Torts* § 874 cmt. a (1939) (citation omitted) (*emphasis added*)].

1.8. The use of the term "best interests" is found in numerous judicial decisions to describe the duty of a fiduciary, not those of a salesperson. This use of the term "best interests," primarily to describe the fiduciary duty of loyalty (the most distinguishing feature of the fiduciary principle), is found in numerous judicial decisions. This author's recent search of a U.S. case law database revealed 963 judicial opinions in which the terms "fiduciary" and "best interests" appeared in the same decision. In addition, there are numerous decisions in other common-law countries, such as the United Kingdom and Australia, that also utilize the term "best interests" to describe the salient feature of the fiduciary obligation.

1.8.1. For example, one U.S. court, recently opining on ERISA's fiduciary duty of loyalty, stated: "ERISA imposes a duty of loyalty on fiduciaries. *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir.), cert. denied, 459 U.S. 1069, 74 L. Ed. 2d 631, 103 S. Ct. 488 (1982) (Friendly, J.). A trustee violates his duty of loyalty when he enters into substantial competition with the interests of trust beneficiaries. *Restatement (Second) of Trusts*, § 170, comment p ... under the law of trusts, a fiduciary is generally prohibited, not just from acting disloyally, but also from assuming a position in which a temptation to act contrary to the *best interests* of the beneficiaries is likely to arise. *Grynberg* at 1319; 2 Scott on Trusts § 170, pp. 1297-98 (1967)."⁵⁹ [*Emphasis added.*]

⁵⁷ *Meinhard vs. Salmon*, 164 N.E. 545 (N.Y. 1928). "Justice Cardozo held that a nonmanaging partner could share in a deal that the owner of the property the partnership managed had offered to the managing partner although the deal would begin after the termination of the partnership's 20-year term and included significant property beyond what the partnership had managed. *Meinhard* provides a workable definition of fiduciary duties as requiring the obligated party to act with the 'finest loyalty' to the owner's interests." Ribstein, Larry E., "The Structure of the Fiduciary Relationship" (January 4, 2003). U Illinois Law & Economics Research Paper No. LE03-003. Available at SSRN: <http://ssrn.com/abstract=397641> or DOI: 10.2139/ssrn.397641

⁵⁸ John H. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?*, 114 Yale L.J. 929, 932 (March 2005). [*Emphasis added.*]

⁵⁹ *Salovaara v. Eckert*, 94 Civ. 3430 (KMW), U.S. D.C. SDNY, 1996 U.S. Dist. LEXIS 323 (1996).

- 1.8.2. In describing an attorney’s fiduciary duty of loyalty to a client, a court stated: “public policy requires that he not be subjected to any possible conflict of interest which may deter him from determining the best interests of the client ... a client's right to the undivided loyalty of his or her attorneys must be protected ... The duty of both the associate and the successor attorney is the same: to serve the *best interests* of the client.”⁶⁰ [*Emphasis added.*]
- 1.8.3. For example, in explaining the duty of loyalty owed by a board of directors to the corporation, the instruction to a lay jury reads: “Each member of the ... board of directors is required to act in good faith and in a manner the director reasonably believes to be in the *best interests* of the corporation when discharging his or her duties.”⁶¹ [*Emphasis added.*]
- 1.8.4. In describing the fiduciary duty of the director of a corporation to the corporation and its shareholders, a court opined: “The duty of loyalty ‘mandates that the *best interest* of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally.’ *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 362 (Del. 1993) (citing *Pogostin v. Rice*, 480 A.2d 619, 624 (Del. 1984) and *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1984)); see also *Diedrick v. Helm*, 217 Minn. 483, 14 N.W.2d 913, 919 (Minn. 1944). The classic example is when a fiduciary either appears on both sides of a transaction or receives a substantial personal benefit not shared by all shareholders. *Id.*”⁶² [*Emphasis added.*]
- 1.8.5. Similarly, “[t]he duty of loyalty requires that the *best interests* of the corporation and its shareholders take precedence over any self-interest of a director, officer, or controlling shareholder that is not shared by the stockholders generally.”⁶³ [*Emphasis added.*]
- 1.8.6. Also, “[I]n dealing with corporate assets [the corporate officer] was required to act in the *best interests* of the corporation and he was prohibited from using either his position or the corporation's funds for his private gain.”⁶⁴ [*Emphasis added.*]
- 1.8.7. While there have been many judicial elicitations of the fiduciary standard, more recent and concise recitation of the fiduciary principle can be found in dictum within the 1998 English (U.K.) case of *Bristol and West Building Society v. Matthew*, in which Lord Millet undertook what has been described as a “masterful survey” of the fiduciary principle:

A fiduciary is someone who has undertaken to act for and on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principle is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not place

⁶⁰ *Beck v. Wecht*, No. S099665, Supreme Court Of California, 28 Cal. 4th 289; 48 P.3d 417; 121 Cal. Rptr. 2d 384; 2002 Cal. LEXIS 4197; 2002 Cal. Daily Op. Service 5812; 2002 Daily Journal DAR 7326 (2002).

⁶¹ *Schultz v. Scandrett*, #27158, Supreme Court of South Dakota, 2015 SD 52; 866 N.W.2d 128; 2015 S.D. LEXIS 85 (June 24, 2015).

⁶² *DQ Wind-Up, Inc. v. Kohler*, Court File No. 27-CV-10-27509, Minnesota District Court, County Of Hennepin, Fourth Judicial District, 2013 Minn. Dist. LEXIS 118 (2013).

⁶³ *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993).

⁶⁴ *Levin v. Levin*, 43 Md. App. 380, 390, 405 A.2d 770 (1979).

himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of the fiduciary obligations. They are the defining characteristics of a fiduciary.⁶⁵

1.9. Numerous law review articles and academic texts also reflect on the fiduciary's obligation to act in the client's (entrustor's) "best interests."

- 1.9.1. "Tracing this doctrine back into the womb of equity, whence it sprang, the foundation becomes plain. Wherever one man or a group of men entrusted another man or group with the management of property, the second group became fiduciaries. As such they were obliged to act conscientiously, which meant *infidelity to the interests of the persons* whose wealth they had undertaken to handle. In this respect, the corporation stands on precisely the same footing as the common-law trust." Adolf A. Berle, Jr. & Gardiner C. Means, *The Modern Corporation and Private Property* 336 (1939). [*Emphasis added.*]
- 1.9.2. "The underlying purpose of the duty of loyalty, which the sole interest rule is meant to serve, is to advance *the best interest* of the beneficiaries ... There can be no quibble with the core policy that motivates the duty of loyalty. Any conflict of interest in trust administration, that is, any opportunity for the trustee to benefit personally from the trust, is potentially harmful to the beneficiary. The danger, according to the treatise writer Bogert, is that a trustee 'placed under temptation' will allow 'selfishness' to prevail over the duty to benefit the beneficiaries. 'Between two conflicting interests,' said the Illinois Supreme Court in an oft-quoted opinion dating from 1844, 'it is easy to foresee, and all experience has shown, whose interests will be neglected and sacrificed' ..." [*Emphasis added.*]
- 1.9.3. "The duty of loyalty requires a trustee 'to administer the trust solely in the interest of the beneficiary' ... The underlying purpose of the duty of loyalty, which the sole interest rule is meant to serve, is to advance the best interest of the beneficiaries ... The law is accustomed to requiring that attorneys zealously pursue their clients' interests and that they not indulge interests that may conflict with those of a particular client without first disclosing the potential conflict to the client and receiving the client's approval. There are some conflicts that cannot be overcome by the client's permission where the conflicted attorney would have to avoid the conflict entirely or quit the representation of the client. Law firms vigorously monitor potential conflicts between attorneys and clients. The rules of professional responsibility go to great lengths to define the appropriate standard of conduct for attorneys and describe what constitutes a conflict and how an attorney, law firm, and client should handle it. These strictly enforced standards of conduct cover every facet of the attorney-client relationship and leave very little to chance in a court's ex post determination of whether an attorney has breached her fiduciary duties. While fiduciary duties may apply to the relationship and zealous advocacy is clearly required, *the obligation an attorney owes a client is ... quite thoroughly described in codes of conduct that have grown ever more complete*

⁶⁵ *Bristol and West Building Society v Mothew* [1998] EWCA Civ 533.

and sophisticated over time.” John H. Langbein, Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?, 114 Yale L.J. 929 (March 2005). [*Emphasis added.*]

1.10. The Commission has also utilized the term “best interests” frequently to describe the fiduciary obligation of investment advisers.

1.10.1. “An essential feature and consequence of a fiduciary relationship is that the fiduciary becomes bound to act in the interests of her beneficiary and not of herself.” *In re Prudential Ins. Co. of America Sales Prac.*, 975 F.Supp. 584, 616 (D.N.J., 1996).

1.10.2. In the SEC’s 2011 “Staff Study on Investment Advisers and Broker-Dealers - As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,” the SEC staff cited *Transamerica Mortgage Advisors, Inc.*, 444 U.S. 11, 17 (1979), stating: “The duty of loyalty requires an adviser to serve the best interests of its clients, which includes an obligation not to subordinate the clients’ interests to its own.”⁶⁶

1.10.3. We also see the term “best interests” used to describe the legal obligations arising for those who provide personalized investment advice to retail customers. On January 22, 2011, the SEC’s Staff, fulfilling the mandate under §913 of the Dodd-Frank Act, released its Study on the regulation of broker-dealers and investment advisers. The overarching recommendation made in the Study is that the SEC should adopt a uniform fiduciary standard for investment advisers and broker-dealers that is no less stringent than the standard under the Advisers Act. Specifically, the Staff recommended the following: “[T]he standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide), shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.” SEC Staff, Study on Investment Advisers and Broker-Dealers ii (2011) [hereinafter SEC Staff Study], available at <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>.

1.10.4. In its 1940 Annual Report, the U.S. Securities and Exchange Commission noted:

If the transaction is in reality an arm's-length transaction between the securities house and its customer, then the securities house is not subject' to 'fiduciary duty. However, the necessity for a transaction to be really at arm's-length in order to escape fiduciary obligations, has been well stated by the United States. Court of Appeals for the District of Columbia in a recently decided case: ‘[T]he old line should be held fast which marks off the obligation of confidence and conscience from the temptation induced by self-interest. He who would deal at arm's length must stand at arm's length. And he must do so openly as an adversary, not disguised as confidant and protector. He cannot commingle his trusteeship with merchandizing on his own account....

Seventh Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1941, at p. 158, citing *Earll v. Picken* (1940) 113 F. 2d 150.

⁶⁶ SEC Staff Study, dated Jan. 21, 2011, at p.22 (available at <http://sec.gov/news/studies/2011/913studyfinal.pdf>.)

- 1.10.5. The Commission also “has held that where a relationship of trust and confidence has been developed between a broker-dealer and his customer so that the customer relies on his advice, a fiduciary relationship exists, imposing a particular duty to act in the customer’s best interests and to disclose any interest the broker-dealer may have in transactions he effects for his customer ... [broker-dealer advertising] may create an atmosphere of trust and confidence, encouraging full reliance on broker-dealers and their registered representatives as professional advisers in situations where such reliance is not merited, and obscuring the merchandising aspects of the retail securities business ... Where the relationship between the customer and broker is such that the former relies in whole or in part on the advice and recommendations of the latter, the salesman is, in effect, an investment adviser, and some of the aspects of a fiduciary relationship arise between the parties.” 1963 SEC Study of the Securities Industry, citing various SEC Releases.
- 1.11. The U.S. Department of Labor’s “Conflict of Interest” and Related Prohibited Transactions Correctly Applied the Term “Best Interests,” but Its Method of Application was not Followed by the Commission.
- 1.11.1. The U.S. Department of Labor proposed to make substantive changes to PTE 84-24, which relates to the sale of fixed-interest annuity contracts (and, before the changes, to fixed indexed annuities). Most importantly, the proposal provided that, in order to qualify for the exemption, insurance and annuity agents must adhere to new “Impartial Conduct Standards.” 2015 Proposed PTE 84-24, 80 Fed. Reg. 22,010, 22,018 (Apr. 20, 2015). Under those standards, the insurance agent and insurance company would be required to act “in the best interest of the plan [or] IRA” and to ensure that statements about investment fees, material conflicts of interest, and other matters directly relevant to the investment decision are not misleading. *Id.* The Department further proposed that an insurance agent or insurance company would be deemed to “act in the ‘[b]est [i]nterest’ of the plan or IRA” when “the fiduciary acts with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances and needs of the [p]lan or IRA, without regard to the financial or other interests of the fiduciary, any affiliate or other party.” *Id.* at 22,020. These conditions parallel the duties of prudence and loyalty found in title I of ERISA. *See* 29 U.S.C. § 1104(a)(1).
- 1.11.2. The Commission’s proposal falls far short of the DOL’s imposition of Impartial Conduct Standards.
- 1.12. Industry Executives Acknowledged, in Sworn Testimony Before Congress, that the Term “Best Interests” Relates to the Obligation of Fiduciaries.
- 1.12.1. In a December 2, 2015 hearing before the Subcommittee On Health, Employment, Labor, And Pensions, of the U.S. House Education and Workforce Committee, Mr. Jules O. Gaudreau, Jr., ChFC, CIC testified, on behalf of the National Association of Insurance and Financial Advisors (NAIFA), under oath: “We already believe that we do engage in the best interests of our clients; we take an ethics pledge on their behalf.”⁶⁷

⁶⁷ Hearing, video record at 1:14.

1.12.2. Subsequently, U.S. Representative Suzanne Bonomaci addressed testimony in an earlier hearing, noting that industry executives all responded affirmatively when she inquired, “Just to be clear, does everyone agree that a ‘best interests’ standard means a ‘best interests’ fiduciary standard?”⁶⁸ Each of the industry executives then answered in the affirmative.

2. **FINRA’s various proposals to advance the use of “best interests” to essentially describe the suitability obligation of broker/dealer firms and their registered representatives, with a slight modification requiring “casual disclosure” of conflicts of interest, is both unfortunate and could cause great harm.**

“I am a stock and bond broker. It is true that my family was somewhat disappointed in my choice of profession.”

– Binx Bolling, *The Moviegoer* (1960)⁶⁹

- 2.1. The Commission’s proposed Regulation Best Interests derives substantially from proposals advanced by FSI and SIFMA, and then endorsed by FINRA, for a “best interests” standard of conduct for brokers, that is nothing more than suitability enhanced by casual disclosures.
- 2.2. These recent efforts by certain actors in the securities industry – including SIFMA and FSI (lobbyist organizations for broker-dealer firms) and FINRA (the self-regulator of broker-dealers, whose members are all broker-dealer firms) – continue to seek to redefine the fiduciary duty of loyalty as a weak disclosure-only requirement. These initiatives included, at first, a “new federal fiduciary standard” or “uniform standard of care,” which has more recently evolved into the advancement of a “best interests” standard that is, in reality, preserving only the profits and “best interests” of broker-dealer firms (and not the “best interests” of their clients). These proposals are contrary to centuries of developed law on fiduciary-client relationships and should be soundly rebuffed.
- 2.3. FINRA’s Efforts to Promote an Illusory “Best Interests” Standard: A Long Record of Deceit.
 - 2.3.1. FINRA and various lobbying firms for broker-dealer firms originally advanced a “best interests” standard. A great deception is occurring by this FINRA, along with brokerage lobbying organizations SIFMA and FSI. These organizations seek to re-define a centuries-old, strict legal standard to a new suitability regime, together with casual disclosure of conflicts of interest combined with securing the customer’s uninformed consent. In so doing, FINRA, which has long resisted the proper application of the fiduciary standard to the investment advice activities of brokers, endorses an exacerbation of consumer confusion as it seeks to further obfuscate the merchandizing role of broker-dealer firms.
 - 2.3.2. In touting a new “best interests” standard that falls far short of a true fiduciary standard of conduct, FINRA perpetuates a 75-year history of opposing the substantial raising of standards of conduct for brokerage firms and their registered representatives. In so doing, FINRA continues its long-standing failure to live up to the hopes of Senator Maloney, who once stated that his Maloney Act of 1938 (which led to the establishment of NASD, now

⁶⁸ Hearing, video record at 1:44.

⁶⁹ Walter Percy, *The Moviegoer* (New York: Ivy Books, 1960), pg. 6.

known as FINRA) had, as its purpose, “the promotion of truly professional standards of character and competence.”⁷⁰

- 2.3.3. It must be recognized that in the early 20th Century, FINRA’s suitability standard was originally designed to mitigate the duty of due care that all service providers possess, in recognition that a broker should not be liable for the default of a security merely for performing “trade execution” services.⁷¹ Inexplicably, however, the suitability standard was expanded in the 1970’s to brokers’ recommendations of investment managers (including mutual fund providers). In turn this has led to a wide plethora of pooled investment vehicles, often expensive, and often with “hidden” revenue-sharing. The result has been widespread harm to investors, given the substantial academic research demonstrating the close relationship between high mutual fund fees and costs and lower returns. Moreover, individual Americans are unable to recover from brokers due to a breach of the duty of due care, since brokers do not possess such a duty – even though nearly every other service provider in the United States possesses such a duty.
 - 2.3.3.1. “Suitability” is a standard that is lower than the typical standard of due care seen by providers of services, such as plumbers, contractors, electricians, etc. Suitability does not require “due care.” For example, suitability does not generally require registered representatives to recommend a lower cost product with identical risk and return characteristics, if one is available.
- 2.3.4. FINRA’s statements over the past few years have often been contradictory. FINRA stated to brokers in its earlier release regarding Rule 2111 that brokers’ recommendations must be consistent with the “best interests” of their customers. Yet, just last year, FINRA stated to the U.S. Department of Labor: “We recognize that imposing a best interest standard requires rulemaking *beyond what is presently in place for broker-dealers.*”⁷² [*Emphasis added.*]
- 2.3.5. In essence, FINRA has long sought to assure the public that protections exist under FINRA regulations, that simply don’t exist. In 2005, FINRA opposed the application of the Advisers Act’s fiduciary duties upon brokers who provided fee-based accounts, even though FINRA acknowledged that, “[f]rom a retail client’s perspective, the differences between investment advisory services and traditional brokerage services are almost imperceptible.”⁷³ Stating that

⁷⁰ Senator Francis T. Maloney, Regulation of the Over-the-Counter Security Markets, Address at the California Security Dealers Association, Investment Bankers Association, National Association of Securities Dealers 2 (Aug. 22, 1939) (transcript available in the SEC Library at 11 SEC Speeches, 1934-61).

⁷¹ See, e.g. Arthur Laby, *Fiduciary Obligations of Broker-Dealers*, 55 Vill.L.Rev. 701, 733-4 (“Although brokers historically provided advice to their customers, advice rendered in the past was relatively less significant in the context of the overall relationship than it is today ... A history of the Merrill Lynch firm explains that, in the early part of the twentieth century, many brokerage firms did not do much more than execution—their sales forces were primarily intermediaries arranging trades on secondary markets—and the information available to investors seeking advice was rather meager. Open a modern description of the activities of broker-dealers and advice often is paramount.”) (*Citations omitted.*)

⁷² FINRA Comment Letter to DOL, July 17, 2015, at p. 3.

⁷³ FINRA Comment Letter to U.S. Securities and Exchange Commission, July 11, 2005, re: “Certain Broker-Dealers Deemed Not to Be Investment Advisers,” Securities Exchange Act Release No. 40980; File No. S7-25-99, at p.2.

“brokerage investors are fully protected”⁷⁴ FINRA even questioned the need for additional disclosures to investors. Also, in a widely criticized statement, FINRA also expressed in 2005 that the SEC’s proposed disclosure for fee-based accounts “implies that customer’s rights, the firm’s duties and obligations, and the applicable fiduciary obligations are greater with respect to an investment adviser account than they are with respect to a brokerage account. As we have previously discussed, this is simply not the case.”⁷⁵ FINRA’s statement is clearly erroneous, as everyone – and their mothers – agree that the fiduciary standard is a much higher standard than the suitability standard.

3. **The use of the term “best interests” in the regulation could lead to a finding of fiduciary status for broker-dealer firms and their registered representatives, under general principles of state common law, exposing them to a higher duty of due care, loyalty and utmost good faith and the potential liability resulting therefrom.**

3.1. The broad fiduciary duties of a broker or insurance agent toward his or her customer are more likely to be found by courts when a *confidential relation* exists, as may occur when *personalized investment advice is provided*. In the United States, our state courts have long applied broad fiduciary duties upon those in relationships of “trust and confidence” with entrustors. As stated by one early 20th Century court:

In equity the court looks to the relationship of the parties -- the reliance, the dependence of one upon the other. Where a relationship of confidence is shown to exist, where trust is justifiably reposed, equity scrutinizes the transaction with a jealous eye; it exacts the utmost good faith in the dealings between the parties, and is ever alert to guard against unfair advantage being taken by the one trusted.⁷⁶

3.2. Under state common law it has long been recognized that the use of a title denoting an advisory role is a significant factor in determining that fiduciary status exists – even for insurance agents.

3.2.1. *Koehler, 1985*. A U.S. District Court in 1985 held that a fiduciary relationship existed in part because of a defendant's status as financial planner to a client. In *Koehler v. Pulvers*, 614 F. Supp. 829 (USDC, Cal, 1985) the defendant, CSCC, was primarily in the business of real estate syndication, but also in business under the name Creative Financial Planning. As stated in the decision, “The developer defendants obtained investment capital from the public by posing as financial planners ... The financial planners typically had a background in either insurance or real estate sales ... As an alleged financial planning company, CSCC, dba Creative Financial Planners, contacted potential investors by conducting Creative Financial Planning seminars open to the public. Utilizing a slick presentation... CSCC attempted to lure investment capital out of savings accounts, home equity, insurance policies, and other conservative investment vehicles and into the speculative real estate ventures it controlled ... At the seminars, CSCC offered to draft a ‘Coordinated Financial Plan’ for attendees at little or no charge. Individuals who accepted this offer received

⁷⁴ *Id.* at p.5.

⁷⁵ *Id.*

⁷⁶ *Jothann v. Irving Trust Company*, 151 Misc. 107; 270 N.Y.S. 721, citing *Wendt v. Fischer*, 215 A.D. 196; 213 N.Y.S. 351 (1926).

recommendations to purchase limited partnership or trust deed interests in CSCC controlled partnerships and project” The court also noted, “Most of the plaintiffs are and were unsophisticated investors. Few had a preexisting relationship with the developer defendants at the time they purchased their securities ... [the investors] relied upon the misrepresentations discussed in detail below. This reliance was reasonable in part because of the developer defendants' purported disinterested financial planner status.”

- 3.2.2. *Cunningham (1990)*. Insurance agents who introduced themselves as “investment counselors or enrollers” and who tailored retirement plans for each person depending on the individual’s financial position, and who led the customers to believe that an investment plan was being drafted for each customer according to each customer’s needs, was held by a federal court, apply Iowa state common law, to lead to the possible imposition of fiduciary status. *Cunningham vs. PLI Life Insurance Company*, 42 F.Supp.2d 872 (1990).
- 3.2.3. *Mathias (2002)*. “In the fall of 1985, plaintiff, having recently divorced and relocated to Columbus, Ohio, sought investment advice from Thomas J. Rosser. At the time, Rosser was a licensed salesman for Great Lakes Securities Company and held himself out as a financial advisor ... [T]he evidence established that Rosser was a licensed stockbroker and held himself out as a financial advisor, and that plaintiff was an unsophisticated investor who sought investment advice from Rosser precisely because of his alleged expertise as a broker and investment advisor. Further, Rosser testified that plaintiff had relied upon his experience, knowledge, and expertise in seeking his advice. Therefore, we conclude that plaintiff presented sufficient evidence to establish that she and Rosser were in a fiduciary relationship.” *Mathias v. Rosser*, 2002 OH 2531 (OHCA, 2002). The court further noted, that under Ohio law, a fiduciary relationship is “a relationship in which one party to the relationship places a special confidence and trust in the integrity and fidelity of the other party to the relationship, and there is a resulting position of superiority or influence, acquired by virtue of the special trust.” *Id.*
- 3.2.4. *Williams (2006)*. In a case arising from Oregon, a self-employed insurance seller and licensed financial planner took advantage of his position as a financial advisor to gain the trust of an 87-year-old man, Stubbs, convincing the elderly man to grant him a power of attorney, with which the financial planner stole about \$400,000. The court held that the licensed financial planner was employed as a fiduciary, specifically noting that the elderly man relied upon the fiduciary as a financial advisor and estate planner. *U.S. v. Williams*, 441 F.3d 716, 724 (9th Cir. 2006).
- 3.2.5. *Hatleberg (2005)*. When a bank held out as either an “investment planner,” “financial planner,” or “financial advisor,” the Wisconsin Supreme Court held that a fiduciary duty may arise in such circumstances. *Hatleberg v. Norwest Bank Wisconsin*, 2005 WI 109, 700 N.W.2d 15 (WI, 2005).
- 3.2.6. *Graben (2007)*. A dual registrant crossed the line in "holding out" as a financial advisor, and in stating that ongoing advice would be provided, and other representations, and in so doing the dual registrant, who sold a variable annuity, and was found to have formed a relationship of trust and confidence with the customers to which fiduciary status attached. "Obviously, when a person such as Hutton is acting as a financial advisor, that role extends

well beyond a simple arms'-length business transaction. An unsophisticated investor is necessarily entrusting his funds to one who is representing that he will place the funds in a suitable investment and manage the funds appropriately for the benefit of his investor/entrustor. The relationship goes well beyond a traditional arms'-length business transaction that provides 'mutual benefit' for both parties." *Western Reserve Life Assurance Company of Ohio vs. Graben*, No. 2-05-328-CV (Tex. App. 6/28/2007) (Tex. App., 2007).

4. **The Commission should take care to not mix two relationships under the law that so many jurists and commentators have opined simply cannot be reconciled: the fiduciary-entrustor relationship and the salesperson-customer relationship.**
 - 4.1. "The obligation of loyalty [understood as the obligation to act with the proper motive] is irreducible and cannot be put on a scale. It applies, or it does not, to a particular decision."⁷⁷
 - 4.2. As the Virginia Supreme Court long ago stated: "It is well settled as a general principle, that trustees, agents, auctioneers, and all persons acting in a confidential character, are disqualified from purchasing. The characters of buyer and seller are incompatible, and cannot safely be exercised by the same person. *Emptor emit quam minimo potest; venditor vendit quam maximo potest*. The disqualification rests, as was strongly observed in the [English] case of the *York Buildings Company v. M'Kenzie*, 8 Bro. Parl. Cas. 63, on no other than that principle which dictates that a person cannot be both judge and party. No man can serve two masters. He that is interested with the interests of others, cannot be allowed to make the business an object of interest to himself; for, the frailty of our nature is such, that the power will too readily beget the inclination to serve our own interests at the expense of those who have trusted us."⁷⁸
 - 4.3. The observation that a person cannot wear two hats and continue to adhere to his or her fiduciary duties was echoed early on by the U.S. Supreme Court, "The two characters of buyer and seller are inconsistent."⁷⁹ The U.S. Supreme Court also observed: "If persons having a confidential character were permitted to avail themselves of any knowledge acquired in that

⁷⁷ Lionel Smith, "The Motive Not the Deed", in *Rationalizing Property, Equity, and Trusts: Essays in Honour of Edward Burn* (London: LexisNexis UK, 2003) 53 at 77.

⁷⁸ See, e.g., *Carter v. Harris*, 25 Va. 199, 204; (Va. 826). The U.S. common law is derived from the laws of England, which law continues to influence the development of U.S. law. In the cited early case, the English court stated: "the rule [prohibiting one from acting as both fiduciary and seller] was founded in reason and nature, and prevailed wherever any well-regulated administration of justice was known; that the disability rested on the principle which dictated that a person cannot be both judge and party, and serve two masters; that he who is intrusted with the interest of others, cannot be allowed to make the business an object to himself, because, from the frailty of human nature, one who has power will be too readily seized with an inclination to serve his own interest at the expense of those for whom he is intrusted; that the danger of temptation does, out of the mere necessity of the case, work a disqualification " nothing less than incapacity being able to shut the door against temptation, when the danger is imminent and the security against discovery great; that the wise policy of the law had therefore put the sting of disability into the temptation, as a defensive weapon against the strength of the danger which lies in the situation; that the parts which the buyer and seller have to act, stand in direct opposition to each other in point of interest; and this conflict of interest is the rock, for shunning which the disability has obtained its force, by making that person who has the one part intrusted to him, incapable of acting on the other side."

⁷⁹ *Wormley v. Wormley*, 21 U.S. 421; 5 L. Ed. 651; 1823 U.S. LEXIS 290; 8 Wheat. 421 (1823).

capacity, they might be induced to conceal their information, and not to exercise it for the benefit of the persons relying upon their integrity. The characters are inconsistent.”⁸⁰

- 4.4. Why should an advisor not attempt to wear two hats? Simply put, because persons are weak. Economic incentives matter a great deal, and drive a person’s actual conduct. Persons are simply unable to not have their advice be affected by the economic temptations (such as for additional compensation) that might exist. As the U.S. Supreme Court opined in its landmark 1963 decision, *SEC vs. Capital Gains Research Bureau*, “the rule ... includes within its purpose the removal of any temptation to violate them ... This Court, in discussing conflicts of interest, has said: ‘The reason of the rule inhibiting a party who occupies confidential and fiduciary relations toward another from assuming antagonistic positions to his principal in matters involving the subject matter of the trust is sometimes said to rest in a sound public policy, but it also is justified in a recognition of the authoritative declaration that no man can serve two masters; and considering that human nature must be dealt with, the rule does not stop with actual violations of such trust relations, but includes within its purpose the removal of any temptation to violate them ... we [previously] said: ‘The objection ... rests in their tendency, not in what was done in the particular case ... The court will not inquire what was done. If that should be improper it probably would be hidden and would not appear.’”⁸¹

5. **The Commission’s use of the term “best interests” could potentially amount to the Commission’s endorsement of fraud.**

- 5.1. The use of the term “best interests” implies duties encompassing due care, loyalty, honesty and integrity, and should not be utilized lightly. Nor should the term “best interests” be utilized as puffery. As Judge Paul Crotty recently cautioned: “Goldman's arguments in this respect are Orwellian. Words such as ‘honesty,’ ‘integrity,’ and ‘fair dealing’ apparently [in Goldman’s eyes] do not mean what they say; [Goldman says] they do not set standards; they are mere shibboleths. If Goldman's claim of ‘honesty’ and ‘integrity’ are simply puffery, the world of finance may be in more trouble than we recognize.”⁸²
- 5.2. When we are dealing with the fiduciary standard of conduct, and its requirement that the fiduciary act in the “best interests” of the entrustor (client), we should not accept half-truths and deception. If the fiduciary standard is to possess meaning, we must hold firms and persons accountable to their words, and not regard these important words as mere “puffery.”
- 5.3. The Commission’s improper use of the term “best interests” may well lead to an inadvertent government endorsement of, or the undertaking of, fraudulent misrepresentation. Section 525 of the Restatement (Second) of Torts provides the general rule for fraudulent misrepresentation: “One who fraudulently makes a misrepresentation of fact, opinion, intention, or law for the purpose of inducing another to act or to refrain from action in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation.”

⁸⁰ *Michoud v. Girod*, 45 U.S. 503; 11 L. Ed. 1076; 1846 U.S. LEXIS 412; 4 HOW 503 (1846).

⁸¹ *SEC v. Capital Gains Research Bureau*, 375 U.S. 180; 84 S. Ct. 275; 11 L. Ed. 2d 237; 1963 U.S. LEXIS 2446 (1963) (citations omitted).

⁸² Judge Paul Crotty in *Richman v. Goldman Sachs Group, Inc.*, 868 F. Supp. 2d 261 (S.D.N.Y. 2012).

To prove common law fraud in most states, the plaintiff must show that:

- the defendant made a material false representation or failed to communicate a material fact, which had the effect of falsifying statements actually made
- the defendant did this intentionally (the defendant knew that the representation or omission constituted a falsehood) or recklessly (the defendant made the representation without regard to whether it was true or false)
- the defendant intended that the plaintiff act on it
- the plaintiff did, in fact, rely on the representation or omission to his or her detriment.

A representation is material if either a substantial likelihood exists that a reasonable person would attach importance to it in making a decision or the person who made the representation has reason to know that the plaintiff is likely to regard it as important in making a decision, even though a reasonable person would not so regard it.

Fraudulent misrepresentation by omission may be actionable if the defendant has a duty to the plaintiff to disclose material facts and fails to do so, and if this failure results in a false impression being conveyed to the plaintiff.

- 5.4. This is a brazen, unjustified attempt by broker-dealer and insurance company organizations and their lobbyists to redefine the English language. The move by lobbying organizations SIFMA, FSI, and NAIFA, with FINRA's endorsement, to promote a new "best interests standard" is nothing more than a brazen, and somewhat bizarre, attempt to usurp the common understanding of both lay persons, as well as practitioners, attorneys, and jurists, by a wholly unjustified and imminently harmful redefinition of the term "best interests."
- 5.5. The use of the term "best interests" to describe a standard of conduct that falls far short of the fiduciary obligation would amount to fraud, as all of the elements of fraud would be present:
- a material false representation of a material fact (by falsely advancing the belief that an insurance producer would act in the customer's "best interest," even though no reliance can actually be placed upon the insurance producer by the customer, and the relationship remains an arms-length relationship, not a bona fide fiduciary relationship under the law);
 - intentionally made (to enhance the marketing and promotion of insurance producer's products);
 - with the intention that consumers act upon it (through reliance, upon the insurance producer, to the detriment of the consumer);
 - leading to such actual reliance on the misrepresentation.

All the elements of intentional misrepresentation – *i.e.*, actual fraud, are present.

Moreover, when a definition is not present in the statute, "the plain and ordinary meaning is derived from the dictionary." *Cox v. Dir. Of Revenue*, 98 S.W.3d 548, 550 (Mo. banc 2003). "Fraud" is defined as "[a] knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment." *Black's Law Dictionary* 731 (9th ed. 2009). "Deceit" is defined as "[t]he act of intentionally giving a false impression." *Id.* at 465. It is also

defined as “[a] false statement of fact made by a person knowingly or recklessly with the intent that someone else will act upon it.”

The Commission should not be a participant in, nor an endorser of, such fraudulent activity.

- 5.6. Proposed Regulation BI may well permit broker-dealers to engage in conduct that would otherwise violate state securities laws and/or other consumer protection laws which prohibit deceit and fraud. For example, Missouri securities legislation makes it unlawful for persons to engage in practices or a course of business that “operates or would operate as fraud or deceit.”⁸³ This language “quite plainly focuses upon the effect of particular conduct on members of the investing public, rather than upon the culpability of the person responsible.”⁸⁴

In Conclusion, the Commission Should Tread Carefully, Should Not Sanction Deceit and Fraud, and Should Abandon its Proposed “Regulation Best Interests.”

In summary, should the Commission proceed with the “best interests” language, as proposed and without the core protections afforded by a bona fide fiduciary standard of conduct, substantial adverse impacts would occur:

- Consumers will be deceived.
- Greater confusion among consumers will exist in the marketplace.
- Consumers’ willingness to participate in the capital markets could be undermined substantially, leading to less formation of capital and lessened U.S. economic growth.
- Great harm would result to consumers across this nation as they rely upon brokers based upon the “best interests” representation, even though such trust and reliance should not occur (as an arms-length relationship still exists). The financial futures of Americans would be put in jeopardy.
- The Commission’s actions could well effect an erosion of the centuries-old fiduciary principle, causing long-term harm to many other forms of fiduciary relationships.

It is essential that the Commission reverse course. The Commission should recognize the simple truth that no man can serve two masters; the role of the product salesperson is simply incompatible with the role of a fiduciary.

⁸³ §409.5-502(a) (emphasis added); *cf.* 17 C.F.R. § 240.10b-5(c)

⁸⁴ *Aaron v. Sec. & Exch. Comm'n*, 446 U.S. 680, 697, 100 S.Ct. 1945, 1955, 64 L.Ed.2d 611 (1980).

The Commission should instead act to ensure that clear distinctions exist between those engaged in arms-length sales transactions as opposed to fiduciary-client relationships. Merchandizing should not be disguised as advice.

The Commission should further ensure all providers of financial and investment advice are subject to a bona fide fiduciary standard of conduct.

Respectfully submitted,

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