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FIDUCIARY OBLIGATIONS OF BROKER-DEALERS AND INVESTMENT ADVISERS

ARTHUR B. LABY*

I. INTRODUCTION

EACH day millions of Americans make critical decisions about which investments to buy or sell based on the recommendations of financial services professionals. These professionals offer advice regarding retirement accounts, college savings plans, and other means through which individuals and families save for their future. Reliance on experts for advice is widespread. Approximately half of all Americans surveyed reported using a financial services provider and nearly three-quarters of those received advisory, management, or planning services.[1] Our collective dependence on financial advisers is unlikely to change anytime soon, especially as more Americans place their savings in stocks or other securities.[2]

Investment professionals who dispense advice are generally either broker-dealers or investment advisers, legal categories that tend to confound investors.[3] Brokers and advisers, however, are subject to different laws and regulations that bear greatly on their duties and responsibilities to clients. Brokerage firms, which historically charge commissions, are

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1. *See* ANGELA HUNG ET AL., INVESTOR AND INDUSTRY PERSPECTIVES ON INVESTMENT ADVISERS AND BROKER-DEALERS 90 (2008) [hereinafter RAND REPORT], http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf.

2. *See* MATTHEW P. FINK, THE RISE OF MUTUAL FUNDS 145-46 (2008) (discussing shift in ownership during 1990s from "real estate and other hard assets to financial assets"); JOINT ECON. COMM., THE ROOTS OF BROADENED STOCK OWNERSHIP 1 (2000), http://www.house.gov/jec/tax/stock/stock.pdf ("In the last decade alone, the number of stockholders has jumped by over fifty percent."); F. THOMAS JUSTER ET AL., THE DECLINE IN HOUSEHOLD SAVING AND THE WEALTH EFFECT ABSTRACT (2004), *available at* http://www.federalreserve.gov/PUBS/feds/2004/200432/200432pap.pdf ("[T]he decline in the personal saving rate since 1984 is largely due to the significant capital gains in corporate equities.").

3. *See* RAND REPORT, *supra* note 1, at 112 ("[M]any survey respondents and focus group participants do not understand key distinctions between investment advisers and broker-dealers—their duties, the titles they use, the firms for which they work, or the services they offer."); *see also* Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm'n, Remarks at CCOutreach National Seminar (Jan. 26, 2010), *available at* http://www.sec.gov/news/speech/2010/spch012610mls.htm ("[M]any investors we serve do not know the difference between an investment adviser and a broker-dealer. The services are often indistinguishable from an investor's perspective.").

regulated under the Securities Exchange Act of 1934 and rules imposed by the Financial Industry Regulatory Authority (FINRA), the self-regulatory organization (SRO) for broker-dealers. Advisory firms, which typically charge asset-based fees, are regulated under the Investment Advisers Act of 1940. Although brokers also give advice, they have shielded themselves from adviser regulation by taking advantage of an exclusion in the Advisers Act.[4] Under this exclusion, as long as a broker's advice is "solely incidental" to brokerage services and the broker charges only commissions and not asset-based fees, the broker is excluded from Advisers Act regulation.[5]

The differences between brokers and advisers are palpable. When a broker-dealer recommends a security, for example, the firm, acting as a dealer, is permitted to sell the security to a customer from the firm's own account—much like an automobile dealer sells its inventory off the lot. By contrast, to guard against conflicts of interest, an investment adviser is severely restricted from selling its own inventory to an advisory client.[6] Although brokers and advisers are regulated differently, many brokers have begun to charge asset-based fees and now market themselves as financial advisers, not stockbrokers; still they continue to avoid regulation under the Advisers Act.[7] The U.S. Securities and Exchange Commission (SEC or Commission) has recognized for over ten years that the two groups are erasing the outward differences between them,[8] and retail customers today see little difference between a broker and an adviser.[9] Confusion over the roles and responsibilities of brokers and advisers led to calls to harmo-

4. *See* Investment Advisers Act of 1940 § 202(a)(11)(C), 15 U.S.C. § 80b-3(a)(11)(C) (2006).

5. *See id.*

6. *See id.* § 206(3), 15 U.S.C. § 80b-6(3).

7. In 2005, the SEC adopted an exemptive rule relieving brokers that charged asset-based fees from application of the Advisers Act as long as certain conditions were met. *See* Certain Broker-Dealers Deemed Not to Be Investment Advisers, Exchange Act Release No. 51,523, Advisers Act Release No. 2376, 70 Fed. Reg. 20,424 (Apr. 12, 2005) [hereinafter Adopting Release]. In 2007, however, the SEC rule was vacated by the D.C. Circuit Court of Appeals, which held that the Commission lacked the statutory authority to adopt the rule. *See* Fin. Planning Ass'n v. SEC, 482 F.3d 481, 483 (D.C. Cir. 2007).

8. *See* Certain Broker-Dealers Deemed Not to be Investment Advisers, Exchange Act Release No. 42,099, Advisers Act Release No. 1845, 64 Fed. Reg. 61,226, 61,229 (proposed Nov. 4, 1999) (explaining that marketing by brokers as advisers raises questions regarding how investors perceive brokers' role).

9. *See Enhancing Investor Protection and Regulation of Securities Markets, Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 111th Cong. 1 (2009), *available at* http://www.sec.gov/news/testimony/2009/ts032609mls.htm (statement of Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm'n) (stating that services provided by brokers and advisers are "virtually identical from the investor's perspective").

nize the bifurcated system of regulation, reaching a crescendo after the financial crisis of 2008.[10]

The duties imposed on brokers and advisers have been fiercely debated in Congress, at the U.S. Treasury Department, and at the SEC.[11] The Dodd-Frank Wall Street Reform and Consumer Protection Act, signed by President Obama on July 21, 2010, requires the SEC to conduct a study to evaluate the standards of care for brokers and advisers and to adopt rules to address any regulatory gaps or overlap identified by the study.[12] Before making final decisions to harmonize the law or impose fiduciary duties, one must determine whether such change is warranted. In a companion article, I explored this question and argued that the broker-dealer exclusion in the Advisers Act has outlived its usefulness.[13] That article, however, did not address the differences between the duties owed by brokers and advisers, an understanding of which is essential to an attempt to harmonize the law.

Advocating harmonization before assessing the obligations that exist today puts the cart before the horse—it assumes that broker-dealers, un-

10. *See SEC Oversight: Current State and Agenda, Hearing Before the Subcomm. on Capital Markets, Insurance and Government-Sponsored Enterprises of the House Comm. on Financial Services*, 111th Cong. 62 (2009) (statement of Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm'n) (stating that financial service providers dispensing advice should be subject to "equivalent regulation"); Tamar Frankel, *Fiduciary Duties of Brokers-Advisors-Financial Planners and Money Managers*, 18 (Boston Univ. Sch. of Law Working Paper No. 09-36, 2009), *available at* http://www.bu.edu/law/faculty/scholarship/workingpapers/2009.html ("Congress should amend the law to impose on b/ds all the duties imposed by the Advisers Act."); Elisse B. Walter, Comm'r, U.S. Sec. & Exch. Comm'n, Regulating Broker-Dealers and Investment Advisers: Demarcation or Harmonization?, Speech at the Mutual Fund Directors Forum Ninth Annual Policy Conference, (May 5, 2009), *available at* http://www.sec.gov/news/speech/2009/spch050509ebw.htm ("[E]very financial professional should be subject to a uniform standard of conduct.").

11. *See, e.g.*, Sara Hansard, *A Bridge Too Far: With Lack of Consensus, the Uniform Fiduciary Standard May Be Left Out of Financial Reform*, 14 INV. NEWS 7 (2010) (describing lack of consensus among groups representing brokers and advisers); Sara Hansard, *Johnson Amendment Would Let Brokers off the Fiduciary Hook*, INV. NEWS, Feb. 16, 2010 (reporting on proposal by Senator Tim Johnson to study issue before acting and opposition by consumer groups); Malini Manickavasagam, *Brokers May Escape Fiduciary Standard Under Final Senate Regulatory Reform Bill*, BNA SECURITIES LAW DAILY, Feb. 4, 2010 (reporting that investor advocates have criticized Senate Banking Committee members who may abandon provision to subject all providers of financial advice to fiduciary obligations).

12. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913 (2010). Initial draft legislation prepared by the Senate Banking Committee handled the problem by striking the broker-dealer exclusion from the Advisers Act, which would have required most brokers that give advice to be regulated as advisers and subject to fiduciary duties. *See* SENATE COMMITTEE ON BANKING, HOUSING & URBAN AFFAIRS, 111TH CONG., RESTORING AMERICAN FINANCIAL STABILITY ACT: CHAIRMAN'S MARK TEXT (2009), *available at* http://banking.senate.gov/public/_files/111609FullBillTextofTheRestoringAmericanFinancialStabilityActof2009.pdf.

13. *See* Arthur B. Laby, *Reforming the Regulation of Broker-Dealers and Investment Advisers*, 65 BUS. LAW. 395 (2010).

like advisers, do not owe a fiduciary duty to their customers and, therefore, change is needed. One can question whether that assumption is correct. On one hand, if brokers owe fiduciary duties to their customers today, imposing a new fiduciary obligation could be redundant. Worse, an attempt to fashion a unitary fiduciary standard might weaken the duties already imposed on advisers.[14] On the other hand, if broker-dealers do not owe fiduciary duties to their customers today, one might ask whether imposing such duties is justified.

This Article addresses these unanswered questions as an important step in determining whether reform is warranted. Ascertaining whether broker-dealers owe a fiduciary obligation to their customers has vexed courts and commentators for decades. This sliver of securities law doctrine comprises a bewildering inconsistency of judicial decisions. The Article, in Part II, explains why this question is so formidable and provides five reasons for the ambiguity in the law. Part III reviews the fiduciary duties imposed on brokers and advisers in their historical context and provides concrete examples where the duties can be differentiated. Part IV explains why a fiduciary obligation should be imposed, albeit cautiously, on brokers that provide advice. The explanation turns on the changed role brokers play in modern securities markets where advice is the coin of the realm and trade execution has receded in importance and become a service obtained at relatively low cost. Part V concludes.

II. SOURCES OF AMBIGUITY

Courts and commentators disagree sharply over the fiduciary obligations of broker-dealers. Many courts adhere to a general rule that brokers are not subject to fiduciary duties unless they have investment discretion over an account.[15] Investment discretion is legal authority, akin to a

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14. *See* Luis A. Aguilar, Comm'r, U.S. Sec. & Exch. Comm'n, SEC's Oversight of the Adviser Industry Bolsters Investor Protection, Remarks at the Investment Advisers Association Annual Conference, (May 7, 2009), *available at* http://www.sec.gov/news/speech/2009/spch050709laa.htm (expressing concern that changes in brokerage and treating brokers like advisers might "undercut fundamental investor protections" in adviser area); *see also* John C. Coffee, Jr. *Changes Needed Before Fed Is Given Regulatory Mission*, N.Y.L.J., July 16, 2009, at 2-3 (expressing concern that harmonization "could weaken the existing fiduciary responsibility of investment advisers"); Liz Horvath, *Bad Advice Biggest Risk for Finances*, MONT. CNTY. HERALD, Feb. 8, 2010 ("Professionals have expressed fears that the focus of regulatory change is aimed mostly at broker-dealers, and might result in a watered-down 'fiduciary-lite' or a 'one-size-fits-all' standard for investment professionals.").

15. *See* SEC v. Pasternak, 561 F. Supp. 2d 459, 499 (D.N.J. 2008) ("[T]he Supreme Court of New Jersey would likely follow the weight of the authority to hold that a broker is in a fiduciary relationship with a client, where that client maintains an account with the broker in which the broker, not the client, retains discretion."); Barbara Black, *Brokers and Advisers—What's in a Name?*, 11 FORDHAM J. CORP. & FIN. L. 31, 36 (2005) (stating that broker-dealers generally do not owe fiduciary duty unless operating with discretion).

power of attorney, to trade on a customer's behalf.[16] California appears to be an exception from the general rule; courts in the Golden State hold that brokers are fiduciaries regardless of the type of account.[17] Other courts flatly disagree with this general rule as well.[18]

The SEC too has been inconsistent in articulating brokers' duties. In the 1980s, the Commission held that just and equitable principles of trade promulgated in SRO rules embody fiduciary responsibilities, although the decision drew two vigorous dissents.[19] More recently, the SEC backed away from this view, stating that, under certain circumstances, such as when a broker assumes a position of trust and confidence, it will be held to a fiduciary standard.[20] Commentators have noted this confusion as well.[21] One writer criticized courts for not performing a careful analysis of the duties imposed on brokers and lamented that this failure results in erroneous or poorly explained decisions.[22] Another noted that courts are inconsistent in their analysis of brokers' fiduciary duties under state law.[23] A third questioned the implications of the fiduciary label.[24]

This part of the Article provides five reasons for the confusion. First, there are relatively few litigated cases discussing brokers' fiduciary duties because brokerage disputes typically are handled through arbitration. Second, when securities cases are brought in court, they usually settle, de-

16. *See* JAMES D. COX, ROBERT W. HILLMAN & DONALD C. LANGEVOORT, SECURITIES REGULATION: CASES AND MATERIALS 1027-28 (6th ed. 2009).

17. *See* Duffy v. Cavalier, 215 Cal. App. 3d 1517, 1536 n.10 (Ct. App. 1989) ("The correct reading of the opinion in *Twomey* is that there is in all cases a fiduciary duty owed by a stockbroker to his or her customers; the *scope* of this duty depends on the specific facts and circumstances presented in a given case.").

18. *See* United States v. Wolfson, Nos. S1 00 Cr. 628(JGK), S1 02 Cr. 1588(JGK), 2008 WL 1969730, at *2 (S.D.N.Y. May 5, 2008) ("The essence of the argument is that there is no fiduciary relation between a broker and a customer unless the broker is handling a discretionary account. That is simply not true.").

19. *See* E.F. Hutton & Co. Inc., Exchange Act Release No. 25,887, 41 SEC Docket 413, 418 (July 6, 1988) ("The concept of just and equitable principles of trade embodies basic fiduciary responsibilities . . . .").

20. *See* Adopting Release, *supra* note 7, at 20,433 n.98 (stating that broker owes fiduciary duties when it assumes position of trust and confidence with its customer, similar to position assumed by investment adviser).

21. *See* Carol R. Goforth, *Stockbrokers' Duties to Their Customers*, 33 ST. LOUIS U. L.J. 407, 431-32 (1989) (discussing inconsistent judicial approaches in determining whether and when fiduciary relationship arises between broker and customer).

22. *See* Cheryl Goss Weiss, *A Review of the Historic Foundations of Broker-Dealer Liability for Breach of Fiduciary Duty*, 23 J. CORP. L. 65, 68 (1997) ("Courts have often failed to do a careful analysis of the duty, resulting in erroneous, confusing or poorly explained opinions.").

23. *See* Steven A. Ramirez, *The Professional Obligations of Securities Brokers Under Federal Law: An Antidote for Bubbles?*, 70 U. CIN. L. REV. 527, 550 (2002) (describing division in state courts regarding fiduciary obligations of broker-dealers).

24. *See* Gregory A. Hicks, *Defining the Scope of Broker and Dealer Duties—Some Problems in Adjudicating the Responsibilities of Securities and Commodities Professionals*, 39 DEPAUL L. REV. 709, 709 (1990) (noting "uncertain significance of the fiduciary label often attached to these [brokers and dealers], and an accompanying uncertainty about the legal duties which the fiduciary label implies").

priving the law of a well-developed body of judicial decisions. Third, even when a court propounds brokers' obligations, questions persist as to whether the duties imposed are mandatory rules or default terms that can be renegotiated on a case-by-case basis. Fourth, brokers' fiduciary duties are the result of a perplexing fusion of state and federal law. Finally, under agency principles, one's fiduciary duties are tied to the scope of one's responsibilities. Because the scope of a broker's responsibilities is often unclear, the attendant duties are similarly ambiguous.

A. *Lack of Litigated Cases*

Most disputes that arise between a brokerage firm and a customer are resolved through SRO arbitration, not litigation. Brokerage agreements typically contain a pre-dispute arbitration clause obligating the customer to arbitrate potential claims.[25] Even when no pre-dispute arbitration agreement exists, brokerage customers generally have the option to pursue their claims in arbitration should they wish to do so.[26] In each of the past five years, breach of fiduciary duty was by far the predominate type of arbitration claim against brokers.[27]

Unlike court litigation, arbitration generally does not yield a well-reasoned written decision. The largest investor arbitration forum is administered by FINRA.[28] FINRA arbitration awards typically contain only factual information such as: the identity of the parties and the arbitrators, a summary of the issues presented, and the relief requested and awarded.[29] Arbitrators prepare an "explained" decision only when all parties jointly request one at least twenty days before the first scheduled hearing.[30] Even when an explained decision is requested, citation to legal authorities is not required.[31] The American Arbitration Association (AAA) has similar

25. In 1987, the Supreme Court held that mandatory arbitration agreements were enforceable to resolve claims under the Securities Exchange Act of 1934. *See* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 238 (1987). Two years later, the Court extended that holding to claims under the Securities Act of 1933. *See* Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 486 (1989).

26. *See* FINRA Manual, FINRA Rule 12201 (2008) (elective arbitration provision) [hereinafter FINRA Manual], *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4107.

27. *See* FINRA, Dispute Resolution Statistics, Arbitration Cases Served by Controversy Involved (2010), http://www.finra.org/ArbitrationMediation/AboutFINRADR/Statistics/index.htm.

28. *See* FINRA Manual, *supra* note 26, at 12200, *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4106.

29. *See id.* at 12904(e).

30. *See id.* at 12904(g)(1). Arbitration cases eligible for such a request are limited to only twenty-five percent of cases filed because this is the percentage of cases actually decided by an arbitrator. FINRA, Dispute Resolution Statistics, How Arbitration Cases Close (2010), http://www.finra.org/ArbitrationMediation/AboutFINRADR/Statistics/index.htm. Others are resolved through alternative means, such as settlement or mediation.

31. *See* FINRA Manual, *supra* note 26, at 12904(g)(2).

rules, under which arbitrators are not required to prepare a reasoned award unless the parties request it in writing before the appointment of the arbitrator or the arbitrator determines that a reasoned award is appropriate.[32]

The explanation for why arbitrators do not provide written decisions can vary. According to some, requiring arbitrators to draft written opinions would undermine the policy behind arbitration—namely, to provide a relatively fast, informal means to resolve disputes.[33] The hardboiled reason arbitrators may be unwilling to draft detailed opinions, however, is probably because they are not paid to do so. Arbitrators receive an honorarium based on time spent in the hearing itself, but not for efforts expended on preparing for the hearing or drafting reasons for their decision.[34]

This lack of explained written decisions impedes development of the law.[35] If required to prepare a written decision, arbitrators presumably would follow a body of past decisions. Written decisions, therefore, would serve as precedent for future proceedings, creating more certainty and predictability in the law. The absence of such decisions makes it more likely that arbitrators will resolve disputes on a case-by-case basis with little or no reference to past practice, resulting in limited continuity in decision-making.

Written decisions also would increase the likelihood of appeals to the federal courts. An arbitration award is generally considered a final disposition binding on both parties.[36] An appeal, however, is possible based on

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32. *See* American Arbitration Association, Commercial Arbitration Rules and Mediation Procedures, R-42 (effective Jan. 1, 2010), *available at* http://www.adr.org/sp.asp?id=22440#R42.

33. *See* Marilyn Blumberg Cane & Ilya Torchinsky, *Explaining "Explained Decisions": NASD's Proposal for Written Explanations in Arbitration Awards*, 16 U. MIAMI BUS. L. REV. 23, 32 (2007) ("[R]equiring arbitrators to explain their reasoning undermines one purpose of arbitration, which is to provide a relatively inexpensive, quick, efficient, and informal means of private dispute settlement.").

34. *See* Barbara Black, *The Irony of Securities Arbitration Today: Why Do Brokerage Firms Need Judicial Protection?*, 72 U. CIN. L. REV. 415, 450 (2003) ("Currently, NASD provides arbitrators with an honorarium based on the time they spend in hearings and not for other tasks" and "[r]equiring arbitrators to provide reasons for their decisions, therefore, will increase the cost of arbitration."). As of 2009, when parties to a FINRA arbitration request an "explained" decision, the chairperson responsible for writing it will receive an additional honorarium of $400. *See* FINRA Manual, *supra* note 26, at 12214(e)(1) ("The chairperson who is responsible for writing an explained decision . . . will receive an additional honorarium of $400.").

35. *See* Kathryn A. Sabbeth & David C. Vladeck, *Contracting (Out) Rights*, 36 FORDHAM URB. L.J. 803, 806 (2009) ("Arbitration does not develop precedent, nor does it allow for appellate review of conflicting decisions.").

36. *See* Brentwood Med. Assocs. v. United Mine Workers, 396 F.3d 237, 241 (3d Cir. 2005) ("[A]n award is presumed valid unless it is affirmatively shown to be otherwise, and the validity of an award is subject to attack only on those grounds listed in 9 U.S.C. § 10, or if enforcement of the award is contrary to public policy.").

certain grounds, such as bias, corruption, or arbitrator misconduct.[37] In addition, some circuit courts permit appeals in the case of "manifest disregard" of the legal standard.[38] Absent a written decision, one cannot determine whether a panel manifestly disregarded the legal standard because one does not know how the arbitrators reached their decision. Justice Blackmun, in his dissent in the Supreme Court case upholding mandatory arbitration agreements, expostulated that the lack of a record and reasoned decision in arbitration proceedings makes judicial review of an arbitrators' award onerous.[39]

Similarly—although for different reasons—there also are few private fiduciary cases brought against investment advisers. This lacuna exists in part because there is only a limited private right of action available under the Investment Advisers Act of 1940. In *Transamerica Mortgage Advisors v. Lewis*,[40] the Supreme Court held that private plaintiffs are only able to sue their advisers under Section 215 of the Act.[41] Section 215 provides that contracts made in violation of the Act, or the performance of which would violate the Act, are void.[42] Damages under this provision are limited to advisory fees paid. Plaintiffs, therefore, cannot sue their advisers for damages incurred as a result of garden-variety Advisers Act violations.[43] It should come as no surprise that regulators, courts, and commentators still look to *SEC v. Capital Gains Research Bureau*,[44] a nearly half-century old Supreme Court case, for the standard articulation of an adviser's fiduciary duties.[45]

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37. *See* United States Arbitration Act, ch. 213, 43 Stat. 883 (1925) (codified as amended at 9 U.S.C. §§ 1-16 (2002)).

38. *See, e.g.*, Williams v. Cigna Fin. Adv. Inc., 197 F.3d 752, 759 (5th Cir. 1999) (summarizing circuit courts accepting "manifest disregard" standard as grounds for vacatur under Federal Arbitration Act); *see also* Lewis v. Circuit City Stores, Inc., 500 F.3d 1140, 1150 (10th Cir. 2007) (stating that court may grant motion to vacate arbitration award under limited circumstances, including manifest disregard of law).

39. *See* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 257 (1987) (Blackmun, J., dissenting).

40. 444 U.S. 11 (1979).

41. *See id.* at 12-13.

42. *See* Investment Advisers Act of 1940 § 215(b), 15 U.S.C. § 80b-15 (2006). Stating that:

> Every contract made in violation of any provision of this subchapter and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of any provision of this title, or any rule, regulation, or order thereunder, shall be void.

Id.

43. A Westlaw search yielded fewer than twenty cases predicated on a violation of Advisers Act § 215.

44. 375 U.S. 180 (1963).

45. *See, e.g.*, SEC v. DiBella, 587 F.3d 553, 567-68 (2d. Cir. 2009); SEC v. Levine, No. 99-02568, 2009 WL 4189646, at *12 (D.D.C. Nov. 24, 2009); Political Contributions By Certain Investor Advisers, Advisers Act SEC Release No. 2910, 2009 WL 2366038 (Aug. 3, 2009); Jennifer S. Taub, *Able But Not Willing: The Failure*

B. *Settlements*

Although there is a dearth of private fiduciary duty actions brought against brokers, there are many such actions brought each year by the SEC.[46] Most SEC actions, however, settle. And when a case settles, the need for a judicial finding of a violation of law is unnecessary, leaving the legal theories used to advance the case untested.[47]

A legal rule established by a settlement often lacks the specificity that accompanies a well-reasoned judicial opinion decided after a case has been litigated on the merits with a fully developed record. SEC settlement documents often contain a long recitation of the facts and a brief conclusion stating that a particular legal provision has been violated.[48] The materials, however, are generally shorn of the critical passages contained in judicial opinions where judges compare and contrast the applicable law in different jurisdictions, or as it has evolved over time, and then apply the law to the relevant facts.[49]

Although settlement may be an efficient resolution of a civil dispute, it imposes hidden costs interrupting the development of the law. In his ground-breaking article, *Against Settlement*, Owen Fiss argued that the machinery of public adjudication, designed to interpret and articulate the values embodied in statutes and the Constitution, lies dormant when parties settle.[50] In those cases, according to Fiss, justice may not be served and the values embodied in a lawsuit may never be expressed or vindi-

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of Mutual Fund Advisors to Advocate for Shareholder Rights, 34 J. CORP. L. 843, 856-57 (2009).

46. In 2009, for example, the SEC brought 109 cases against broker-dealers (against a total of 182 defendants or respondents) and 76 cases against investment advisers (against a total of 227 defendants or respondents). U.S. SEC. AND EXCH. COMM'N, SELECT SEC AND MARKET DATA FISCAL 2009, *available at* http://www.sec.gov/about/secstats2009.pdf. These numbers underestimate the actual number of cases brought against broker-dealers and investment advisers. In counting cases, the SEC includes each action brought in only one category, although many actions involve multiple allegations and fall under multiple categories. *See id.*

47. *See* ROBERTA KARMEL, REGULATION BY PROSECUTION 166, 174 (1982).

48. The relevant SEC document is the Order Instituting Proceedings in an SEC Administrative Proceeding or a Litigation Release and civil complaint in a district court proceeding. *See, e.g.*, Morgan Stanley DW, Inc., Securities Act Release No. 8339, Exchange Act Release No. 48,789, Administrative Proceedings File No. 3-11335 (Nov. 17, 2003), *available at* http://www.sec.gov/litigation/admin/33-8339.htm; SEC Settles Insider Trading Charges with Four Individuals, Litigation Release No. 20,895 (Feb. 10, 2009) *available at* http://www.sec.gov/litigation/litreleases/2009/lr20895.htm. Courts are aware of their limited role in approving settlements and state explicitly that they are not being called on to decide issues on the merits, but rather to consider the nature of the claims and determine whether the proposed settlement is reasonable. *See* Perrine v. Pennroad Corp., 47 A.2d 479, 488 (Del. 1946).

49. *See* KARMEL, *supra* note 47, at 220.

50. *See* Owen M. Fiss, *Against Settlement*, 93 YALE L.J. 1073, 1089 (1984) ("[C]ivil litigation is an institutional arrangement for using state power to bring a recalcitrant reality closer to our chosen ideals.").

cated.[51] One of the examples Fiss relies on is the "private attorney general," where Congress actually promoted litigation to remedy public wrongs.[52] The private attorney general example has been recognized in the context of securities litigation.[53] Securities settlements, therefore, hobble the development of the law in one of the areas where justice promoted through litigated cases is needed most.

The combination of these two conditions—the lack of private actions alleging breach of fiduciary duty by brokers and the settlement of most cases filed—results in an underdeveloped jurisprudence. As described next, even those cases that litigate often are unhelpful in understanding the fiduciary duties of brokers.

C. *Contractual Variation*

Although some cases regarding brokers' fiduciary duties have led to litigation, there is sharp disagreement over whether the duties described in these cases are mandatory rules or default terms that can be varied by contract.[54] This question is an additional source of ambiguity in the law. To the extent that fiduciary law consists of default terms that can be renegotiated by the parties, courts could no sooner articulate generally applicable fiduciary rules than they could articulate generally applicable contractual terms, such as price or quantity in a bill of sale.

Under the contractual view, fiduciary duties are merely default contractual terms to which the parties would have agreed if they had unlimited resources to bargain.[55] This view is borne out in many statutory

51. *See id.* at 1085 ("A settlement will thereby deprive a court of the occasion, and perhaps even the ability, to render an interpretation.").

52. *See* Fortner Enters. v. U.S. Steel Corp., 394 U.S. 495, 502 (1969) ("Congress has encouraged private antitrust litigation not merely to compensate those who have been directly injured but also to vindicate the important public interest in free competition."); Newman v. Piggie Park Enters, Inc., 390 U.S. 400, 401 (1968) ("When the Civil Rights Act of 1964 was passed, it was evident that enforcement would prove difficult and that the Nation would have to rely in part upon private litigation as a means of securing broad compliance with the law.").

53. *See* Piper v. Chris-Craft Indus., 430 U.S. 1, 61 n.13 (1977) (Stevens, J., dissenting) (recognizing that enforcement of Securities Exchange Act through private suits for monetary damages is analogous to concept of "private attorney general" in civil rights or antitrust context); *In re* Merrill Lynch & Co., Fed. Sec. L. Rep. (CCH) ¶ 94,515 (S.D.N.Y. 2007) ("The concept of a private attorney acting as a private attorney general is vital to the continued enforcement and effectiveness of the Securities Acts.").

54. Paul S. Miller, *Congress, Corporate Boards, and Oversight: A Public/Private Law Comparison*, 44 U. RICH. L. REV. 771, 792-94 (2010) (describing thirty year old disagreement between contractarian and anti-contractarian camps regarding fiduciary duties).

55. *See e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 427 (1993) (making standard defense of this view); *see also* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 34 (1991) (explaining that fiduciary obligation "fills in the blanks and oversights with the terms that people would have bargained for had they anticipated the problems and been able to transact costlessly in advance"); Henry N.

provisions and in certain case law. For example, Delaware partnership law states that partners can vary or eliminate liability for breach of duty, including fiduciary duties.[56] Similarly, Delaware corporate law allows a corporation to limit the personal liability of directors even when they breach their duty of care.[57]

Others maintain that there is a core fiduciary duty not subject to negotiation or wavier.[58] The exculpation provision of Delaware corporate law, for example, is inapplicable if the relevant conduct was not in good faith or amounted to breach of the duty of loyalty.[59] The law of partnership, although giving partners great flexibility to contract freely, contains non-negotiable liability for violation of the implied contractual promise of good faith and fair dealing.[60] Thus, even those provisions designed to provide fiduciaries freedom of contract contain certain immutable principles. Similarly, many courts deny the contractual approach.[61]

There is a lively academic debate over the contractual nature of the fiduciary relationship.[62] This question exacerbates the ambiguity surrounding brokers' fiduciary duties. Even if particular duties can be articu-

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Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1, 4 (1990) (responding to commentators who argue that private ordering of managers' duties should be subject to mandatory rules); John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 657 (1995) (explicating contract theory of fiduciary duty, with duty of loyalty performing gap-filling role).

56. *See* DEL. CODE ANN. tit. 6, § 15-103(f) (2005) (providing for ability to limit liability for breach of fiduciary duty).

57. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2001) (same).

58. *See* Scott FitzGibbon, *Fiduciary Relationships Are Not Contracts*, 82 MARQ. L. REV. 303, 305 (1999) ("This Article explores the nature of fiduciary relationships, shows that they arise and function in ways alien to contractualist thought, and that they have value and serve purposes unknown to the contractualists."); Tamar Frankel, *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209, 1211-12 (1995) (arguing that "most fiduciary rules constitute default rules" that cannot be waived); Arthur B. Laby, *The Fiduciary Obligation as the Adoption of Ends*, 56 BUFF. L. REV. 99, 104-29 (2008) (rejecting contractual approach as descriptive theory of fiduciary duties); Melanie B. Leslie, *Trusting Trustees: Fiduciary Duties and the Limits of Default Rules*, 94 GEO. L.J. 67, 70 (2005) (explaining that calling fiduciary duties default rules removes their moral content).

59. *See* Stone v. Ritter, 911 A.2d 362, 367 (Del. 2006) (explaining that Section 102(b)(7) "can exculpate directors from monetary liability for a breach of the duty of care, but not for conduct that is not in good faith or a breach of the duty of loyalty").

60. *See* DEL. CODE ANN. tit. 6, § 15-103(f) (prohibiting elimination of fiduciary duty of good faith).

61. *See* Harbison v. Strickland, 900 So. 2d 385, 389 (Ala. 2004) ("The Legislature has imposed on corporations and partnerships fiduciary duties that cannot be waived."); *see also* BT-1 v. Equitable Life Assurance, 75 Cal. App. 4th 1406, 1410, 1412 (Ct. App. 1999) ("[T]he fiduciary duties of [a general partner to a limited partner] loyalty and good faith cannot be waived . . . . [A] limited partnership agreement cannot relieve the general partner of its fiduciary duties in matters fundamentally related to the partnership business.").

62. *See, e.g.*, *supra* note 58.

lated, one must consider whether the duties imposed can be altered by mutual agreement. This, however, is a deep question not addressed by most courts deciding fiduciary disputes.

D. *State Law*

A fourth source of confusion over brokers' fiduciary obligations arises because the duties emanate from both federal and state law. Cases against brokerage firms often are brought under the Securities Exchange Act. Section 10 of the Act and Rule 10b-5 contain general prohibitions against fraud.[63] Section 15(c)(1) prohibits a broker-dealer from engaging in a transaction through any manipulative, deceptive, or other fraudulent device or contrivance.[64]

Understanding the duties imposed on brokers by Exchange Act Sections 10 and 15 requires an analysis of the state law of fiduciaries. Under these provisions, courts hold that a broker-dealer selling securities from its own account has a duty of disclosure only when the seller is in a fiduciary relationship with the buyer or when a mark-up charged is excessive.[65] In order to determine whether one owes a fiduciary duty in this context, and the scope of the duties imposed, the federal court must analyze relevant state law.[66] State law in areas such as agency, trust, guardianship, business organizations, and attorney-client relationships is where fiduciary law developed and matured.[67]

Variations regarding brokers' obligations under state law abound, however, and adulterate the federal cases with inconsistencies. In Oklahoma, for example, a fiduciary relationship exists where a weaker party places confidence and responsibility in a stronger one, and a fiduciary breach occurs when the stronger party takes advantage of the weaker.[68] In Texas, fiduciary duties arise when parties enter into a rela-

63. *See* Securities Exchange Act of 1934 § 10, 15 U.S.C. §§ 78j, 78l (2000) (prohibiting fraud in connection with sale of securities); *see also* Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (2009) (same).

64. *See* Securities Exchange Act of 1934 § 15(c)(1), 15 U.S.C. § 78o(c)(1).

65. *See* Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 534 (2d Cir. 1999) ("A seller such as the defendant only has a duty to disclose the specifics of a markup—under the rubric of the obligation under Section 10(b) to 'disclose material information'—when there is either a fiduciary relationship with the complaining party or when the markup is 'excessive.'").

66. *See id.* at 536 (looking to New York law to determine fiduciary status).

67. *See* Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 908 (1988) ("Paradigms of [fiduciary] relationships include agent-principal, director-corporation, guardian-ward, lawyer-client, partner-fellow partner, and trustee-trust beneficiary relationships.").

68. *See* MidAmerica Fed. Sav. & Loan Assoc. v. Shearson/American Express Inc., 886 F.2d 1249, 1259 (10th Cir. 1989) (stating that "a fiduciary duty exists when the party in the weaker position reasonably places its confidence and responsibility in the party in the stronger position").

tionship that is not arm's length.[69] In New York, brokers owe fiduciary duties only when they have discretion over an account.[70] In view of such diversity, courts recognize explicitly that the states lack a unitary rule.[71]

In addition, the misapplication of state law occasionally produces perplexing results, which further muddle the law. In *Associated Randall Bank v. Griffen*,[72] the Seventh Circuit stated that under Wisconsin law, a broker-dealer is not a fiduciary in the case of a non-discretionary account.[73] Although that last claim is uncontroversial, the court went on to state that because the broker was not acting as a fiduciary, the broker was not subject to the general "suitability" requirement to recommend only suitable investments to a customer.[74] The suitability requirement imposed by FINRA, however, does not turn on the application of state law, but rather on FINRA rules.[75] Authority for FINRA rules derives from the Exchange Act, not state law, and the rules are applicable to all member firms.[76]

The complexity imposed by state law does not arise in the context of investment advisers. Advisers operate under a federal fiduciary standard

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69. *See* Banca Cremi, S.A. v. Alex. Brown & Sons, Inc., 132 F.3d 1017, 1038 (4th Cir. 1997) ("[T]he Bank's employees have made it abundantly clear that the defendants did not act as agents for the Bank, but rather conducted their business at arm's length in a principal-to-principal relationship. . . . There was accordingly no formal relationship giving rise to a fiduciary duty, and the record reveals no informal relationship which could allow the imposition of such a duty.").

70. *See* Indep. Order of Foresters v. Donaldson, 157 F.3d 933, 940-41 (2d Cir. 1998) (explaining broker's fiduciary duty arises "only where the customer has delegated discretionary trading authority to the broker").

71. *See* Patsos v. First Albany Corp., 741 N.E.2d 841, 849-51 (Mass. 2001) ("Courts in other States have not been of single mind whether fiduciary duties inhere in every relationship between a stockbroker and his customer."); *see also* Johnson v. John Hancock Funds, 217 S.W.3d 414, 428 (Tenn. Ct. App. 2006) (same).

72. 3 F.3d 208 (7th Cir. 1993).

73. *See id.* at 212 (describing limit to fiduciary role of broker-dealer).

74. *See id.* (stating that customer demanded and exercised final say over its account and concluding that "Wisconsin therefore did not require Kubik to recommend only securities 'suitable' to the Bank's portfolio"); *see also* Tatum v. Legg Mason Wood Walker, Inc., 83 F.3d 121, 123 (5th Cir. 1996) ("Under Mississippi law, a broker-dealer operating a non-discretionary account has no duty to determine the suitability of a customer's trades or to prevent the customer from losing money.").

75. *See* NASD Rule 2310(a) (1996), *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3638 ("In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.").

76. *See* Maloney Act of 1938, 15 U.S.C. § 78o-3 (2006) (adding Section 15A to Securities Exchange Act of 1934 and establishing system of self-regulation for broker-dealers); *see also* FINRA Manual, *supra* note 26, at Rule 0140 ("The Rules shall apply to all members and persons associated with a member.").

through application of the Investment Advisers Act.[77] When determining an adviser's fiduciary duty under the Advisers Act, courts consult federal cases; reference to inconsistent state laws governing fiduciaries is unnecessary.[78] One court explicitly recognized that declining to consider state law promotes uniformity in the law governing advisers.[79]

Application of state law, therefore, is relevant to determining the fiduciary duties of brokers. Unlike the law of advisers, federal courts look to state law to determine whether brokers should be deemed fiduciaries and the scope of the duties imposed. State law varies, however, which leads to inconsistent results.

E. *Scope*

A final reason why a broker's fiduciary duty is difficult to specify relates to the scope of the broker's agency. Under agency law, the extent of one's fiduciary duty is limited by the scope of one's agency.[80] The scope of one's agency depends in turn on the power that the principal has accorded the agent over the principal's interests.[81] Thus, in determining the nature of a broker's fiduciary duty, one must analyze the broker's power over the assets or affairs of the customer. This principle often is stated in the language of trust: a broker's fiduciary duty is limited to matters relevant to the affairs entrusted to him or her.[82]

Ascertaining a broker's power over an account and the corresponding extent of the broker's fiduciary duties is a difficult exercise. Formal control over an account occurs only when a customer provides the broker with discretionary authority. As discussed below, most courts and commentators agree that when a broker has discretionary authority, the broker owes

77. For further discussion of the Investment Advisers Act, see *infra* note 98 and accompanying text.

78. *See* Laird v. Integrated Res., Inc., 897 F.2d 826, 837 (5th Cir. 1990) ("[C]oncerning entanglement with state law, because our holding encompasses a developed federal standard it does not require reference to state corporate and securities law or the state law of fiduciary relationships.") (citations omitted).

79. *See id.* at 837 (explaining that uniformity in Advisers Act law is promoted because state law need not be considered).

80. *See* Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 536 (2d Cir. 1999) (stating that fiduciary obligation between broker and customer as matter of New York law is limited to matters relevant to affairs entrusted to broker); Rush v. Oppenheimer & Co., 681 F. Supp. 1045, 1055 (S.D.N.Y. 1988) ("The fiduciary obligation that arises between a broker and a customer as a matter of New York common law is limited to matters relevant to affairs entrusted to the broker."); O'Malley v. Boris, 742 A.2d 845, 849 (Del. 1999) (stating that broker-dealer is accountable under fiduciary standard for those decisions over which it had discretionary authority).

81. *See* RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. e (2006) ("Any agent has power over the principal's interests to a greater or lesser degree. This determines the scope in which fiduciary duty operates.").

82. *See Press*, 166 F.3d at 536 ("[T]he fiduciary obligation that arises between a broker and a customer as a matter of New York common law is limited to matters relevant to affairs entrusted to the broker . . . ." quoting *Rush*, 681 F. Supp. at 1055)).

fiduciary duties to its customer.[83] The more difficult cases are those where the customer has not delegated formal discretion to the broker. In those instances, a broker still may have effective control over a customer's account if the customer always follows the broker's advice.[84] Moreover, the level of trust a customer reposes in a broker can change over time. A relationship that at one point may have been arm's length, can transform into a fiduciary relationship as the association between the broker and the customer intensifies.[85]

Determining a broker's control over an account is also complicated by the fact that in any brokerage account, advice must be "solely incidental" to brokerage or the broker-dealer exclusion in the Advisers Act will not be available and the broker will be considered an adviser.[86] If the broker's advice is merely incidental to brokerage and the customer has the final say, this arrangement might suggest that the broker's power over the account is limited and no fiduciary duty is owed. But what if the advice—although solely incidental to brokerage—is always followed by the customer? Has the broker in that case assumed effective control over the account?

Courts determine issues of scope on a case-by-case basis. *O'Malley v. Boris*[87] is a good example. In that case, the O'Malleys gave their broker very little authority over their account and, for most investment decisions, the O'Malleys were consulted before any trading occurred. The O'Malleys, however, gave their broker authority to choose a "sweep" account, an account into which any cash in the brokerage account periodically would be "swept." As a result, the broker's choice of sweep account for the O'Malleys was a decision reviewed under a fiduciary standard.[88] As the next part of this Article demonstrates, however, there is little agreement over whether or when a broker owes fiduciary duties to a customer with a non-discretionary account.

The difficult exercise of determining the scope of the broker's activity results in an equally difficult exercise of specifying a broker's fiduciary duty. For this reason and the others discussed above, sketching brokers' fiduciary duties is a challenging affair. Despite these handicaps, Part III

83. *See infra* notes 150-57 and accompanying text.

84. *See* Cruse v. Equitable Sec. of N.Y., Inc., 678 F. Supp. 1023, 1030-31 (S.D.N.Y. 1987) ("Although a securities account may be non-discretionary, a broker may still effectively exercise *de facto* control where a customer places his trust and faith in a broker and routinely follows his broker's advice.").

85. *See id.*

86. *See supra* note 8 and accompanying text.

87. 742 A.2d 845, 849 (Del. 1999).

88. *See id.* at 849 (finding that fiduciary standard is applicable for decisions made by broker-dealer for customers). The court ruled for the O'Malleys because the disclosure regarding conflicts of interest in the choice of a sweep account did not satisfy the fiduciary duty of full disclosure. *See id.* at 851 (holding for plaintiffs).

examines the respective duties of brokers and advisers with emphasis on how the law has evolved.

III. FIDUCIARY DUTIES OF BROKERS AND ADVISERS

The fiduciary duties imposed on broker-dealers and investment advisers differ. The most apparent contrast is that under federal law, investment advisers, unlike brokers, are always considered fiduciaries to their clients. Appearances, however, can be deceiving. Brokers were, and often still are, considered fiduciaries as well. This Part reviews and then contrasts the fiduciary obligations imposed on brokers and advisers.

A. *Investment Advisers*

1. *Federal Fiduciary Standard*

The Investment Advisers Act contains a general antifraud provision, which the Supreme Court has interpreted as imposing a fiduciary duty on advisers.[89] In *SEC v. Capital Gains Research Bureau*, the Court reviewed an SEC enforcement action against an advisory firm for a practice known as scalping.[90] Scalping occurs when an adviser purchases a security for its own account and then recommends the same security to its clients without disclosing the firm's ownership.[91] The adviser then sells its shares at a profit. This practice may injure a client for at least two reasons. First, the adviser's trading may diminish the investors' profits. The client's purchase price may have been lower or the sale price higher had the adviser not bought or sold in advance of the client. Second, scalping presents an egregious conflict of interest because of the risk that the adviser is recommending the security not on the merits, but only to prop up the price.

The Court held that scalping was a breach of the adviser's fiduciary duty and a violation of the antifraud provision of the Act.[92] Advisers, the Court concluded, must adhere to a strict fiduciary standard including a duty of "utmost" good faith, full and fair disclosure of all material facts, and an obligation to use reasonable care to avoid misleading clients.[93] The *Capital Gains Research Bureau* Court followed a trope that can be traced to centuries-old trust law, where courts prohibited trustees from

89. Even advisers regulated by the states are subject to the antifraud provision of the Advisers Act. *See* Investment Advisers Act of 1940 § 206, 15 U.S.C. § 80b-6 (2006).

90. *See* SEC v. Capital Gains Research Bureau, 375 U.S. 180, 181 (1963) (holding that Investment Advisers Act prohibits scalping).

91. *See* SEC v. Park, 99 F. Supp. 2d 889, 892 (N.D. Ill. 2000) (defining scalping).

92. *See Capital Gains Research Bureau*, 375 U.S. at 201 ("The high standards of business morality exacted by our laws regulating the securities industry do not permit an investment adviser to trade on the market effect of his own recommendations without fully and fairly revealing his personal interests in these recommendations to his clients.").

93. *See id.* at 194 (describing fiduciary duty).

transacting in trust property and required use of reasonable care, skill, and caution in investing.[94] Subsequent courts have interpreted *Capital Gains Research Bureau* to establish a federal fiduciary standard for advisers. For instance, in *Santa Fe Industries, Inc. v. Green*,[95] the Supreme Court stated that although the *Capital Gains Research Bureau* case involved a statute, the Advisers Act's reference to fraud and the principle of equity implies that Congress intended to establish "federal fiduciary standards."[96]

The *Capital Gains Research Bureau* case and the establishment of fiduciary duties has become the cynosure of the federal regulatory scheme for advisers. Nearly fifty years after the case was decided, regulators, courts, and commentators still look to *Capital Gains Research Bureau* for the standard articulation of an adviser's fiduciary duties.[97] But what does a federal fiduciary standard entail? Although disagreement exists, the standard does not incorporate the entire body of state law with respect to fiduciary obligation. One leading case, *Steadman v. SEC*,[98] stated explicitly that the federal fiduciary standard of *Capital Gains Research Bureau* encompasses less than the full panoply of common law fiduciary duties.[99] As men-

94. The principles of loyalty and care espoused in *Capital Gains Research Bureau* are cornerstones of the so-called "Prudent Investor Rule," which governs the investment of trust funds. *See* RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. c (2007) ("The strict duty of loyalty in the trust law ordinarily prohibits the trustee from investing or managing trust investments in a manner that will give rise to a personal conflict of interest."); *id.* cmt. d ("The duty of care requires the trustee to exercise reasonable effort and diligence in making and monitoring investments for the trust, with attention to the trust's objectives."). The Prudent Investor Rule can be traced to the 1830 case of *Harvard College v. Amory*, 26 Mass. (9 Pick.) 446 (1830). *See* RESTATEMENT (THIRD) OF TRUSTS, Prudent Investor Rule, Introductory Note (describing origin of Prudent Investor Rule). *Harvard College v. Amory* stated that trustees should "observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds . . . ." *Harvard College*, 26 Mass. (9 Pick.) at 461. *Cf.* Jones v. Harris Assocs., 527 F.3d 627, 632 (7th Cir. 2008), *vacated*, 130 S. Ct. 1418 (2010) (explaining that use of term fiduciary in Investment Company Act with respect to advisers "is to summon up the law of trusts").

95. 430 U.S. 462, 472 n.11 (1977).

96. *See id.* ("Although *Capital Gains* involved a federal securities statute, the Court's references to fraud in the 'equitable' sense of the term were premised on its recognition that Congress intended the Investment Advisers Act to establish federal fiduciary standards for investment advisers."); *see also* Transamerica v. Lewis, 444 U.S. 11, 17 (1979) ("As we have previously recognized, § 206 establishes 'federal fiduciary standards' to govern the conduct of investment advisers . . . .").

97. *See, e.g.*, SEC v. DiBella, 587 F.3d 553, 567-68 (2d. Cir. 2009); SEC v. Levine, No. 99-02568, 2009 WL 4189646, at *12 (D.D.C. 2009); Political Contributions By Certain Investor Advisers, Advisers Act Release No. 2910 (Aug. 3, 2009); Jennifer S. Taub, *Able But Not Willing: The Failure of Mutual Fund Advisors to Advocate for Shareholder Rights*, 34 J. CORP. L. 843, 856-57 (2009).

98. 603 F.2d 1126 (5th Cir. 1979).

99. *See id.* at 1142 ("We do not think this overall purpose is a warrant to read section 206(1) and (2) of the IAA, the sections found to have been violated here, as the vehicle to reach all breaches of fiduciary trust."). *But see In re* Brandt, Kelly & Simmons, LLP, SEC Release, 2004 WL 2108661, at *2 (Sept. 21, 2004) (stating that Advisers Act "incorporate[s] common law principles of fiduciary duties").

tioned, the federal standard imposed on advisers can be ascertained without reference to state law.[100]

2. *Implications for Advisers*

The application of fiduciary duties has important implications for advisers. First, the fiduciary standard generally employed by the courts requires that an adviser must act in the "best interest" of its advisory client.[101] Under a "best interest" test, an adviser may benefit from a transaction with or by a client, but the transaction must be fully disclosed.[102] Disclosure of conflicts of interest, such as in *Capital Gains Research Bureau*, has been a flash point for determining liability under the Advisers Act.

Take the case of *Monetta Financial Services, Inc. v. SEC.*[103] In that case, an investment adviser, Monetta Financial Services, was offered valuable shares in initial public offerings (IPOs) by various broker-dealers.[104] Monetta allocated the shares to its advisory clients, which included certain mutual funds managed by Monetta, as well as some of the fund trustees. Although there was no evidence that it allocated the shares inequitably, Monetta did not disclose to the funds (or to the non-client trustees of the funds) that it allocated certain shares to other trustees, who were clients.[105] The court held that Monetta's failure to disclose the allocation violated the antifraud rules of the Advisers Act. Allocating some of the shares to trustee clients meant that fewer were available for the funds themselves. The clients effectively were vying for the same valuable asset. Moreover, Monetta had an incentive to favor the trustee clients over both non-trustee clients and fund clients because the trustee clients wielded power over whether Monetta would continue to serve as adviser to the funds. The mere potential for abuse was sufficient to require disclosure under the Advisers Act.[106]

100. *See* Laird v. Integrated Res., Inc., 897 F.2d 826, 837 (5th Cir. 1990) ("The Supreme Court has recognized the investment advisers' fiduciary status. Courts may refer to these cases instead of state analogies in deciding whether this status prohibits particular conduct."); *see also supra* notes 77-79 and accompanying text.

101. *See, e.g.*, SEC v. Tambone, 550 F.3d 106, 146 (1st Cir. 2008) ("Section 206 imposes a fiduciary duty on investment advisers to act at all times in the best interest of the fund and its investors.").

102. *See* SEC v. Capital Gains Research Bureau, 375 U.S. 180, 191-92 (1963) (stating that Advisers Act was meant to "eliminate, or at least to expose, all conflicts of interest which might incline as investment adviser–consciously or unconsciously–to render advice which was not disinterested").

103. 390 F.3d 952 (7th Cir. 2004).

104. *See id.* at 954 (describing facts of case).

105. *See id.* (same).

106. *See id.* at 955 ("That MFS did not, in fact, favor the director-clients over the funds is of no consequence because the potential for abuse nonetheless existed."); *see also* Vernazza v. SEC, 327 F.3d 851, 860 (9th Cir. 2003) (failure to disclose incentives to adviser for certain recommendations made to clients); Laird v. Integrated Res., Inc., 897 F.2d 826, 835 (5th Cir. 1990) (adviser failed to disclose that he earned commissions from investments recommended to clients); SEC v.

The advisers' best interest standard is not limited to disclosing conflicts of interest. An adviser has a duty, borrowed from broker-dealer regulation, to undertake a suitability analysis to ensure that securities the adviser recommends are suitable to a client's circumstances.[107] An adviser must have a reasonable basis for making particular recommendations.[108] In addition, an adviser must seek "best execution" of a client's securities transactions.[109] According to the SEC, an adviser should periodically evaluate the quality of execution it is receiving for its clients.[110]

B. *Broker-Dealers*

Fiduciary law governing broker-dealers is more ambiguous than the law that governs advisers. Conventional analysis often appears to be that brokers, in the case of standard non-discretionary accounts, do not owe their customers fiduciary duties.[111] The *Rand Report* states that unlike advisers, brokers do not categorically owe fiduciary duties.[112] Industry experts call the potential shift to a fiduciary standard for brokers a fundamental change.[113] The *Wall Street Journal* reported that although advisers are held to a fiduciary standard, brokers are required only to recommend investments that are "suitable."[114] And the SEC's new authority to hold brokers to a fiduciary standard suggests that this heightened duty is not applicable today. A closer examination, however, reveals a closer question.

Blavin, 760 F.2d 706, 711-12 (6th Cir. 1985) (adviser failed to disclose that he was trading securities his newsletter recommended).

107. *See* Suitability of Investment Advice Provided by Investment Advisers; Custodial Account Statements for Certain Advisory Clients, Advisers Act Release No. 1406, 59 Fed. Reg. 13,464, (Mar. 16, 1994) (describing suitability rules applicable to broker-dealers).

108. *See* Registration Under the Advisers Act of Certain Hedge Fund Advisers, Advisers Act Release No. 2333, 69 Fed. Reg. 72,054, 72,054 (Dec. 2, 2004) ("A number of obligations to clients flow from [an adviser's] fiduciary duty, including the duty . . . to have a reasonable basis for client recommendations."). This Advisers Act Release was later vacated on other grounds by a D.C. Circuit case in 2006. *See* Goldstein v. Sec. and Exch. Comm'n, 451 F.3d 873 (D.C. Cir. 2006).

109. *See In Re* Portfolio Advisory Serv., Advisers Act Release No. 2038, 2002 WL 1343823, at *2 (June 20, 2002) ("An investment adviser's fiduciary duty includes the requirement to seek best execution of client securities transactions.").

110. *See* Interpretive Release Concerning Scope of Section 28(e) of the Securities Exchange Act of 1934, Exchange Act Release No. 23,170, 51 Fed. Reg. 16,004, 16,011 (Apr. 23, 1986) ("[M]oney managers should periodically and systematically evaluate the execution performance of broker-dealers executing their transactions.").

111. For a definition of discretion, see *supra* note 16 and accompanying text.

112. *See* RAND REPORT, *supra* note 1, at 10.

113. *See* Kristina Fausti, *The Fiduciary Challenge*, REGISTERED REP., Aug. 2009, at 61-62; Randall Smith & Aaron Lucchetti, *Relief and Resignation on Wall Street*, WALL ST. J., June 18, 2009, at A14.

114. *See* Jane J. Kim & Aaron Lucchetti, *Big Changes in Store for Brokers in Obama's Oversight Overhaul*, WALL ST. J., June 19, 2009, at C1.

1. *The Historical Approach*

Notwithstanding the conventional wisdom that brokers generally are not fiduciaries, historically, many courts and commentators took the opposite view. A fiduciary standard for brokers has a long tradition. In 1697, the British Parliament passed a securities statute entitled, An Act to Restrain the Number and Ill Practice of Brokers and Stock Jobbers.[115] The statute, in existence for a little over ten years, required brokerage firms and their employees to take a verbal oath comparable to the modern fiduciary obligation.[116] In an 1861 case, *Conkey v. Bond*,[117] which foreshadowed modern debates over fiduciary norms, the court held that a broker—who should have acted as an agent—breached its fiduciary duty when it transacted as a principal absent disclosure.[118] Another nineteenth century court held that brokers were fiduciaries because their activities were akin to the conduct of trustees or pledgees.[119]

In the early part of the twentieth century, many courts and commentators continued to treat broker-dealers as fiduciaries.[120] A 1940 treatise noted that the "fiduciary character" of the broker-customer relationship was beyond question.[121] It would be a mistake, however, to put too much weight on those older cases. The context in which early courts imposed

115. *See* An Act to Restrain the Number and Ill Practice of Brokers and Stock Jobbers, 1697, 8 & 9 Will. 3, c. 32 (Eng.) [hereinafter Statutes], *available at* http://www.british-history.ac.uk/report.aspx?compid=46880; STUART BANNER, ANGLO-AMERICAN SECURITIES REGULATION: CULTURAL AND POLITICAL ROOTS, 1690-1860 39 (1998).

116. *See* Statutes, *supra* note 115 (requiring brokers to state, "I. A. B. doe sincerely promise and swear That I will truly and faithfully execute and perform the Office and Employment of a Broker between Party and Party in all things appertaining to the Duty of the said Office and Employment without Fraud or Collusion to the best of my Skill and Knowledge and according to the Tenor and Purport of the Act instituted to restrain the Number and ill Practice of Brokers and Stock-Jobbers. So help me God."); *see also* RALPH F. DE BEDTS, THE NEW DEAL'S SEC: THE FORMATIVE YEARS 2 (1964).

117. 34 Barb. 276 (N.Y. Gen. Term 1861), *aff'd*, 36 N.Y 427 (1867).

118. *See id.*

119. *See* Brown v. Runals, 14 Wis. 693, 696 (1861) ("Thus a fiduciary relation is created between the parties in respect to the pledge, from which arises various obligations and duties. . . . Where a fiduciary relation subsists between the parties, whether it be the case of an agent or a trustee, or a broker, or whether the subject matter be stock, or cargoes, or chattels of whatever description, the court will interfere to prevent a sale, either by the party entrusted with the goods, or by persons claiming under him through an alleged abuse of power.") (citing Wood v. Rowcliffe, (1844) 67 Eng. Rep. 397, 381 (Ch.)).

120. *See* Rubin v. Salomon, 241 N.Y.S. 495, 496 (N.Y. Mun. Ct. 1930) ("A fiduciary relation exists between the broker and the customer."); Wahl v. Tracy, 12 N.W. 660, 661 (Wis. 1909) (stating that broker, by accepting employment, becomes agent of customer and owes "ordinary fiduciary duties of good faith and due diligence"); *see generally* Cheryl Goss Weiss, *A Review of the Historic Foundations of Broker-Dealer Liability for Breach of Fiduciary Duty*, 23 IOWA J. CORP. L. 65, 77 n.89 (1997) (citing cases).

121. *See* 1 WILLIAM HERMAN BLACK, THE LAW OF STOCK EXCHANGES, STOCKBROKERS & CUSTOMERS 211-12 (1940).

these duties was not the same context in which fiduciary issues are debated today.

Recall that broker-dealers act as both brokers (agents buying and selling on behalf of their customers) and dealers (principals trading securities with their own customers). One would expect a broker acting as an agent to be held to a fiduciary standard. According to both the *Restatement (First) of Agency* from 1933[122] and the *Restatement (Second)* from 1958,[123] an agency relationship is a fiduciary relationship. Many early cases stated that broker-dealers owed fiduciary duties not because they served in an advisory capacity, but rather because they were entrusted as agents with the customer's cash or securities and owed a duty to carry out the customer's instructions in good faith and with due diligence.[124] An influential study from this era entitled *The Security Markets*—prepared by a team of thirty economists and associates of the Twentieth Century Fund—stated that a broker acts as a fiduciary to a customer account when the broker has custody of the funds or securities in the account. Otherwise, a broker's liability is limited to the proper execution of the customer's orders.[125]

Unlike a broker acting as an agent, a dealer acts more akin to a merchant attempting to market and sell a product, and a dealer generally is not considered a fiduciary.[126] In a series of dealer cases decided around the time the Advisers Act was passed, however, the SEC established an enhanced standard of conduct for dealers and brokers.[127] The dealer cases put substance over form. The Commission held that even when a firm was

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122. *See* RESTATEMENT (FIRST) OF AGENCY § 1, cmt. b on subsection (1) (1933) ("Agency results only if there is an agreement for the creation of a fiduciary relationship with control by the beneficiary.").

123. *See* RESTATEMENT (SECOND) OF AGENCY § 1(1) (1958) ("Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act."); *see also* Weiss, *supra* note 120, at 67. The same fiduciary principle is continued in the *Restatement (Third)*. *See* RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006) ("Agency is the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act.").

124. *See, e.g.*, *In re* Ruskay, 5 F.2d 143, 144 (2d Cir. 1925) ("[W]hen the petitioner paid money to the bankrupts for the purchase of the stock they occupied a fiduciary relation to him and held the money so received solely for the purchase of the stock."); Lipkien v. Krinski, 182 N.Y.S. 454, 192 A.D. 257, 263 (N.Y. App. Div. 1920) (holding that transferring cash to broker gives rise to fiduciary duty regardless of defendants' claim that they were only clearing broker); *Wahl*, 121 N.W. at 661 ("By such acceptance they became agents of the plaintiff and, being intrusted with his money for a special purpose, owed to him the ordinary fiduciary duties of good faith and due diligence in carrying out his instructions.").

125. *See* TWENTIETH CENTURY FUND, THE SECURITY MARKETS 231 (1938).

126. *See* Weiss, *supra* note 120, at 67.

127. *See In re* Duker & Duker, 6 S.E.C. 386, 388-89 (1939) ("Inherent in the relationship between a dealer and his customer is the vital representation that the customer will be dealt with fairly, and in accordance with the standards of the profession. It is neither fair dealing, nor in accordance with such standards, to

transacting with a customer as a dealer, it undertook to act on the customer's behalf and, therefore, the relationship was similar to agency.

Although the Commission did not hold that dealers owed fiduciary duties per se, it used language resonant of fiduciary law. The SEC referred to the trust and confidence customers reposed in the firm and lectured in the moralizing style familiar of fiduciary disquisitions, stating that exploitation of the customer's trust contravened a duty of fair dealing.[128] Thus began the Commission's development of a theory of liability for broker-dealers, which came to be called the "shingle" theory.[129]

The SEC first applied the shingle theory in the context of a dealer charging excessive mark-ups. It was called the shingle theory because the broker-dealer firm was hanging out its shingle, offering to act on the customer's behalf, and therefore should be subject to enhanced duties.[130] The shingle theory was tested and affirmed by the Second Circuit in *Charles Hughes & Co. v. SEC.*[131]

Under the shingle theory, the SEC did not impose strict fiduciary duties on broker-dealers. Rather, the standard applied by the Commission was that the brokers' conduct be reasonable under the circumstances.[132] A reasonableness requirement, however, falls short of the best interest standard required of a fiduciary.[133] Moreover, the SEC recently has taken the position that the shingle theory applies to broker-dealers regardless of whether a fiduciary relationship arises, thereby separating the standards required by the shingle theory on one hand, and the fiduciary obligation on the other.[134]

Fiduciary law applicable to broker-dealers continued on a crooked path. By the late 1940s, the SEC and the courts seemed to step away from applying fiduciary principles to brokers. A leading case is *In re Arleen W. Hughes v. SEC,*[135] in which a dually registered broker-dealer and investment adviser failed to disclose its adverse interest in certain customer transactions. The court held that the firm, in line with its fiduciary duty as

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exploit trust and ignorance for profits far higher than might be realized from an informed customer."); *In re* Jansen & Co., 6 S.E.C. 391, 394 (1939) (same).

128. *See Duker*, 6 S.E.C. at 389.

129. *See* THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION § 14.15[3] (5th ed. 2006).

130. *See id.*

131. 139 F.2d 434 (2d Cir. 1943), *cert. denied*, 321 U.S. 786 (1944).

132. *See Duker*, 6 S.E.C. at 389 (noting that dealer's price must be reasonably related to market price or dealer must disclose information to allow customer to make informed decisions).

133. Laby, *supra* note 13, at 427 ("The gap between prohibiting an unreasonable price and helping the customer obtain the best price is vast, and it represents the difference between the duty of fair dealing and the fiduciary obligation.").

134. *See* Brief of SEC Securities & Exchange Commission as Amicus Curiae on Issues Presented at 23, *In re* Refco, Inc. Sec. Litig., 609 F. Supp. 2d 304 (S.D.N.Y. 2009) (Nos. 08-6167-cv(CON), 08-6230-cv(CON)) (explaining that shingle theory is not predicated on existence of fiduciary relationship).

135. 174 F.2d 969 (D.C. Cir. 1949).

an *adviser*, was required to disclose the nature and extent of any conflict of interest, including the cost to the firm of acquiring the securities for sale. At the administrative level, however, the SEC stated that it did not intend to apply a fiduciary standard to brokers that qualified for the broker-dealer exclusion in Section 202(a)(11)(C) of the Advisers Act.[136] The SEC, however, included a caveat—a broker could not avail itself of the exclusion if it placed itself in a position of trust and confidence.[137] Later, the Commission expanded the shingle theory to apply to a wide variety of cases when brokers held themselves out as experts and induced customers to rely on their expertise. The theory was applied to a broker, who by making stock recommendations, impliedly represented that he or she had adequate information to recommend the particular issue.[138] Although the SEC has continued to state that a relationship of trust and confidence can transform a garden-variety brokerage account into a fiduciary relationship,[139] many modern courts have not gone that far.

2. *The Modern Approach*

Modern law remains ambiguous. Courts have looked to a number of factors to determine whether brokers are fiduciaries, such as account documentation, the extent to which the customer follows the broker's advice, the frequency of communications between the parties, the customer's investment experience, personal ties between the broker and the customer, and the degree of discretion reposed in the broker.[140] The last factor—whether an account is discretionary—is usually determinative. Most courts, looking to state law for guidance, conclude that only brokers for discretionary, as opposed to non-discretionary, accounts are considered fiduciaries.[141]

136. *See In re* Arleen W. Hughes, 27 S.E.C. 629, 639 (1948) ("[I]t is not intended that the disclosure requirements, which we have found applicable to registrant, be imposed upon broker-dealers who render investment advice merely as an incident to their broker-dealer activities.").

137. *See id.*

138. *See* Hanly v. SEC, 415 F.2d 589, 596 (2d Cir. 1969) ("A securities dealer occupies a special relationship to a buyer of securities in that by his position he implicitly represents he has an adequate basis for the opinions he renders.").

139. *See* Adopting Release, *supra* note 7, at 20,433; Certain Broker Dealers Deemed Not to Be Investment Advisers, Exchange Act Release No. 50,980, Advisers Act Release No. 2340, 70 Fed. Reg. 2716, 2721 (proposed Jan. 14, 2005); *see also* Weiss, *supra* note 120, at 95-96 (noting that under trust and confidence approach, broker-dealers' duties result from holding themselves out as possessing special knowledge and skill and from cultivating the customers' trust).

140. *See* Patsos v. First Albany Corp., 741 N.E.2d 841, 849-51 (Mass. 2001); Schuster v. Dacey, No. 2007-00617(SUCV), 2008 WL 2415190 (Mass. Super. 2008).

141. *See* Assoc. Randall Bank v. Griffin, Kubik, Stephens & Thompson, Inc., 3 F.3d 208, 212 (7th Cir. 1993) ("A broker-dealer in Wisconsin is not a fiduciary with respect to accounts over which the customer has the final say . . . ."); Leib v. Merrill Lynch, Pierce, Fenner & Smith, 461 F. Supp. 951, 953 (E.D. Mich. 1978) ("Unlike the broker who handles a non-discretionary account, the broker handling a discretionary account becomes the fiduciary of his customer in a broad sense."), *aff'd,*

There are at least two reasons behind the general rule. First, as a practical matter, investment discretion is a useful proxy for measuring trust and confidence, a badge of the fiduciary relationship. In deciding whether a fiduciary relationship exists in other contexts, courts often stress the degree of trust and confidence reposed by the principal in the agent.[142] Whether an account is discretionary provides a clean dividing line to assess whether trust has been reposed. A customer who cedes discretion must trust the broker unreservedly because the broker is authorized to make investment decisions without checking with the customer in advance.[143]

A good example of the emphasis on discretion is *Lefkowitz v. Smith Barney, Harris Upham & Co.*[144] In that case, the personal representative of an estate sued a brokerage firm and the account representative for breach of fiduciary duty for failing to disclose the unsuitability of investments in the decedent's account.[145] In affirming the lower court's dismissal, the court of appeals explained that "a simple stockbroker-customer relationship does not constitute a fiduciary relationship in Massachusetts."[146] Lefkowitz argued this was not a simple relationship because the decedent was closely acquainted with the account representative and always accepted

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647 F.2d 165 (6th Cir. 1981). *But see* MidAmerica Fed. Sav. & Loan Ass'n v. Shearson/American Express, Inc., 886 F.2d 1249, 1258 (10th Cir. 1989) ("Although the fact that MidAmerica's account with Shearson was nondiscretionary would generally cut against the finding of a fiduciary relationship, here that fact is not sufficient to defeat MidAmerica's claim."); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1026 (6th Cir. 1979) ("This holding is also consistent with the fact that a broker-dealer is a fiduciary who owes his customer a high degree of care in transacting his business."); *see also* RAND REPORT, *supra* note 1, at 10 (stating that "most critical distinction" with regard to whether brokers are deemed fiduciaries is whether account is discretionary).

142. *See* Litton Indus., Inc. v. Lehman Bros. Kuhn Loeb Inc., 767 F. Supp. 1220, 1231 (S.D.N.Y. 1991) ("Although the existence of fiduciary relationships under New York law cannot be determined by recourse to rigid formulas, New York courts typically focus on whether one person has reposed trust or confidence in another who thereby gains a resulting superiority or influence over the first."), *rev'd on other grounds*, 967 F.2d 742 (2d Cir. 1992); Wiener v. Lazard Freres & Co., 672 N.Y.S. 2d 8, 14 (N.Y. App. Div. 1998) (to determine whether fiduciary relationship exists, "a court will look to whether a party reposed confidence in another and reasonably relied on the other's superior expertise or knowledge . . . ."); Ed Schory & Sons, Inc. v. Soc. Natl. Bank, 662 N.E.2d 1074, 1081 (Ohio 1996) (defining fiduciary relationship as one where confidence and trust is reposed by one and a resulting superiority or influence acquired by the other); Estate of Beal, 769 P.2d 150, 154 (Okla. 1989) (fiduciary relationship "exists whenever trust and confidence are placed by one person in the integrity and fidelity of another . . . .").

143. *See* Press v. Chem. Inv. Servs. Corp., 988 F. Supp. 375, 386 (S.D.N.Y. 1997) ("The crucial factor in determining whether a broker has been 'entrusted' with particular matters such that a fiduciary obligation attaches, appears to be whether the broker exercises discretion over those matters.").

144. 804 F.2d 154, 155 (1st Cir. 1986) (per curiam).

145. *See id.*

146. *Id.*

the representative's advice.[147] If any set of facts presented a strong case for fiduciary duties, it was this. The court, however, stated that minimal knowledge of investments and "blind reliance" on the broker does not give rise to a fiduciary obligation.[148]

A second explanation for why discretion often proves determinative is that the fiduciary obligation serves as a necessary substitute for the customer's monitoring of the account.[149] Monitoring by a customer is less likely to occur when a broker has discretion. In a non-discretionary account, the broker checks with the customer before each trade, providing the customer an opportunity to monitor the broker's conduct. In that case, a good broker might choose to keep an eye on the customer's account between trades, but it is not a legal requirement.[150] The Second Circuit affirmed this principle in *Kwiatkowski v. Bear, Stearns & Co.*,[151] stating that a broker owes no duty to monitor a nondiscretionary account—its duties end after each transaction.[152]

Although courts impose fiduciary duties on brokers administering non-discretionary accounts, those duties last only for the narrow window when the broker is executing a transaction.[153] A fiduciary duty in the execution of the transaction, however, does not add significant new responsibilities to the obligation already imposed on the broker. It is simply an additional duty to accomplish a task already required.[154]

The court restricted the broker's fiduciary duty to the limited act of execution in *Caravan Mobile Home Sales, Inc. v. Lehman Brothers Kuhn Loeb, Inc.*[155] In that case, a trustee of two employee trusts of Caravan Mobile Homes opened a non-discretionary account with Lehman Brothers and, in late 1981, invested in Nucorp Energy, Inc. on Lehman's advice. Nucorp

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147. *See id.*

148. *Id.*

149. *Cf.* Lisa M. Fairfax, *Spare the Rod, Spoil the Director? Revitalizing Directors' Fiduciary Duty Through Legal Liability*, 42 HOUS. L. REV. 393, 455 (2005) ("[T]he monitoring functions inherent in directors' fiduciary obligations recognize the vital role directors must play in ensuring that officers do not misuse their corporate authority.").

150. *See* Leib v. Merrill Lynch, Pierce, Fenner & Smith, 461 F. Supp. 951, 953 (E.D. Mich. 1978), *aff'd*, 647 F.2d 165 (6th Cir. 1981).

151. 306 F.3d 1293 (2d Cir. 2002).

152. *See id.* at 1302.

153. *See* Limbaugh v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 732 F.2d 859, 862 (11th Cir. 1984) ("The duty owed by the broker was simply to execute the order.").

154. *See* Hill v. Bache Halsey Stuart Shields Inc., 790 F.2d 817, 825 (10th Cir. 1986) ("[The] fiduciary duty in the context of a brokerage relationship is only an added degree of responsibility to carry out pre-existing, agreed-upon tasks properly.").

155. 769 F.2d 561 (9th Cir. 1985); *see also* Hoffman v. UBS-AG, 591 F. Supp. 2d 522, 535 (S.D.N.Y. 2008) ("[I]t is well-established Second Circuit law that the fiduciary duty in the broker/customer relationship is only to 'the narrow task of consummating the transaction requested.'" (quoting Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 536 (2d Cir. 1999))).

soon filed for bankruptcy. The trustee sued Lehman on the trusts' behalf alleging that a managing director of Lehman, also a director of Nucorp, possessed material, non-public information about Nucorp's eventual demise at the time the trusts invested. The trusts argued that three parties (the director, Lehman, and the broker on the account) were fiduciaries to the Caravan trusts. The court explained that a stockbroker's duty begins when the customer places an order and ends when it is completed.[156] The plaintiffs "failed to offer any proof that Lehman Brothers owed a fiduciary duty to the Caravan trusts after the Nucorp purchases."[157] The court in *Caravan Mobile Home Sales* took a nuanced approach, distinguishing brokers from advisers and concluding that there was "no showing that defendants exercised continuing control over Caravan's account or acted as investment counselors."[158]

3. *Contrasting the Duties of Brokers and Advisers*

Although brokers generally are not considered fiduciaries, their duties are not insubstantial. Before making a recommendation, brokers must have "reasonable grounds" for believing a recommendation is suitable.[159] They must comply with "know your customer" rules, which require them to undertake due diligence to learn key facts about their own customers.[160] Moreover, brokers are subject to the antifraud provisions of the Exchange Act, which prohibit any person from making material misstatements and omissions in connection with the purchase or sale of securities.[161] One might ask, therefore, even if brokers are not labeled fiduciaries, is there really a difference between the regulation of brokers and advisers?

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156. *See Caravan Mobile Home Sales*, 769 F.2d at 567.

157. *See id.*

158. *See id.*

159. *See* NASD Rule 2310(a) (1996), *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3638 ("In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."); *see also* FINRA Regulatory Notice 09-25 (May 2009), *available at* http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=11485&element_id=8374&highlight=09-25#r11485 (proposing to consolidate and replace NASD Rule 2310 with FINRA Consolidated Rule 2010).

160. *See* NYSE Rule 405(1) (2008) (NYSE members must "[u]se due diligence to learn the essential facts relative to every customer, every order, every cash or margin account accepted or carried by such organization and every person holding power of attorney over any account accepted or carried by such organization.").

161. *See* Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2000).

a. Nature of the Relationship

Although the differences may be exaggerated, the fiduciary obligation imposed by the Advisers Act appears broader than the duties imposed on brokers through application of the Exchange Act's antifraud rules and FINRA requirements. The primary reason for this stems from the way courts and regulators view the scope of activity undertaken by each when administering non-discretionary accounts. As discussed, the duty imposed on an agent depends on the scope of his or her activity.[162] Although the scope of activity can be altered by contract, in the case of non-discretionary accounts, a broker's activity generally is limited to conduct surrounding a particular transaction, whereas the scope of an adviser's activity extends beyond a particular trade. The different scope of activity yields different duties.

Consider the scope of activity undertaken by advisers. In some cases, an adviser might limit its advice to providing a financial plan, or it might restrict its advice to a particularly type of security, such as municipal bonds, or a particular sector, like technology.[163] In those cases, the adviser's fiduciary duty would be commensurate with the scope of the relationship. Most advisers, according to the *Rand Report*, however, agree to provide portfolio management services.[164] The phrase "management services" connotes an ongoing relationship, which extends beyond the time a particular trade is made. Moreover, the scope of activity for federally registered advisers is usually to provide ongoing, continuous services, even for a non-discretionary account.[165]

162. For a discussion of the duty imposed on an agent, see *supra* notes 81-88 and accompanying text.

163. *See* CLIFFORD E. KIRSCH, INVESTMENT ADVISER REGULATION 1-1 (2d ed. 2009).

164. *See* RAND REPORT, *supra* note 1, at 40.

165. Here is the explanation: The SEC registration form for investment advisers seeks information about the dollar amount of an adviser's assets under management. The dollar amount is important because, as of the date of publication of this Article, only those advisers with at least $25 million of assets under management are generally permitted to register with the SEC; advisers with under $25 million typically must register with the relevant state authority. *See* Investment Advisers Act § 203A(a)(1), 15 U.S.C. § 80b-3a(a)(1) (2006) ("No investment adviser that is regulated or required to be regulated as an investment adviser in the State in which it maintains its principal office and place of business shall register under section 203, unless the investment adviser . . . has assets under management of not less than $ 25,000,000 . . . ."). In calculating the amount of assets under management, the adviser may count only those assets over which it provides "continuous and regular supervisory or management services . . . ." Securities and Exchange Commission, Form ADV, Instruction 5(b) for Part 1, 19 C.F.R. § 279.1 (2008), *available at* http://www.sec.gov/about/forms/formadv-instructions.pdf. The SEC has defined the phrase "continuous and regular supervisory or management services" as discretionary authority or "ongoing responsibility" to recommend securities based on the client's needs and arranging for the relevant transaction. *See id.* at Instr. 5(b)(3). Moreover, an adviser does *not* provide continuous and regular supervisory management services if it provides advice "on an intermittent or periodic basis." *Id.* Thus, although it might be possible for an adviser to contract to

If an adviser has agreed to provide continuous supervisory services, the scope of the adviser's fiduciary duty entails a continuous, ongoing duty to supervise the client's account, regardless of whether any trading occurs. This feature of the adviser's duty, even in a non-discretionary account, contrasts sharply with the duty of a broker administering a non-discretionary account, where no duty to monitor is required.[166] The two accounts in this example are similar in nature—both the broker and the adviser hold themselves out as providing non-discretionary investment advice—yet the adviser's duty entails ongoing diligence while the broker's duty is episodic.

This distinction between episodic duties under the Exchange Act and ongoing duties under the Advisers Act for similarly structured accounts tallies with other provisions of the statutes. Under Exchange Act Section 10(b) and Rule 10b-5, conduct must be "in connection with" the purchase or sale of securities.[167] There must be a purchase or sale of securities before liability arises.[168] This is not the case under the Advisers Act, which prohibits an adviser from defrauding a client or prospective client; an actual purchase or sale is not needed.[169] Moreover, according to some courts, Advisers Act violations in SEC actions do not depend upon actual injury to a client. Unlike private litigants, the SEC does not need to prove that a client relied on an adviser's misrepresentation or that the misrepresentation caused harm.[170] One court has gone so far as to say that an adviser can violate Section 206(4) of the Act even if no identifiable client is in the picture.[171] The Advisers Act contains a catch-all prohibition, which does not refer to clients or prospective clients.[172] The distinction between episodic and ongoing duties also is consistent with the way lead-

provide services not considered continuous and regular, nearly all advisers registered with the SEC must meet the "continuous and regular" criteria.

166. For a discussion of the duties of brokers and non-discretionary accounts, see *supra* notes 111-14 and accompanying text.

167. *See* Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2000).

168. *See, e.g.*, Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 739-43 (1975) (citing Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952)) (affirming *Birnbaum* rule that plaintiffs alleging violations of Exchange Act Rule 10b-5 must be actual purchasers or sellers of securities).

169. *See* Investment Advisers Act § 206, 54 Stat. at 852 (codified at 15 U.S.C. § 80b-6 (2009)).

170. *See* SEC v. Blavin, 760 F.2d 706, 711 (6th Cir. 1985) ("Unlike private litigants seeking damages, the Commission is not required to prove that any investor actually relied on the misrepresentations or that the misrepresentations caused any investor to lose money.").

171. *See* United States v. Elliott, 62 F.3d 1304, 1311 (11th Cir. 1995) ("Lacking any reference to clients, subsection (4) [of Investment Advisers Act section 206] appears to be a general prohibition against certain conduct by an investment adviser.").

172. *See* Investment Advisers Act § 206(4), 15 U.S.C. § 80b-6(4) (2006) (stating that it shall be unlawful for any adviser "to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative"); *Elliott*, 62 F.3d at 1312 ("[C]ongress's primary concern appeared to be the possible limitations imposed by common-law concepts of fraud and deceit.").

ing treatises, Congress, and the courts historically have conceptualized the scope of the advisory relationship and the resulting duties.[173]

b. Duty of Disclosure

The 1940s Congress drafting the Advisers Act, and the SEC and the courts in the decades to follow, were deeply concerned about conflicts of interest in the advisory relationship.[174] Although a broker's failure to disclose a conflict can lead to liability under Section 10(b) of the Exchange Act and Rule 10b-5,[175] an adviser must abide by a higher standard under Section 206 of the Advisers Act, which is the general antifraud provision applicable to all advisers. Liability under Section 10 of the Exchange Act and Rule 10b-5 requires proof of scienter.[176] Although liability under Section 206(1) of the Advisers Act requires proof of scienter as well, anti-fraud liability under Section 206(2) does not.[177] In addition, as discussed, unlike the Exchange Act, illegal conduct under the Advisers Act does not have to be tied to a particular transaction—Advisers Act liability is broader in scope.[178] The heightened standard for advisers is a key difference be-

173. The Security Markets study from the 1930s explained that advisers agreed to keep their clients constantly informed about whether changes in their accounts needed to be made. *See* TWENTIETH CENTURY FUND, *supra* note 125, at 649. The 1940s Congress picked up on this theme, quoting the testimony of the President of the Investment Counsel Association of America, who described the function of the profession as rendering "continuous advice" regarding the management of a client's investments. *See* INVESTMENT TRUSTS AND INVESTMENT COMPANIES, REPORT OF THE SEC. AND EXCH. COMM'N, PURSUANT TO SECTION 30 OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935, INVESTMENT COUNSEL, INVESTMENT MANAGEMENT, INVESTMENT SUPERVISORY, AND INVESTMENT ADVISORY SERVICES, H.R. DOC. NO. 76-477, at 28 (1939). The Supreme Court echoed this description of advisory services in *Capital Gains Research Bureau.* SEC v. Capital Gains Research Bureau, 375 U.S. 180, 187 (1963) (describing advisers' "basic function" as "furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments . . . ." (quoting INVESTMENT TRUSTS AND INVESTMENT COMPANIES, *supra*)). Courts continue to stress the ongoing nature of an adviser's duties. *See In re* David Henry Disraeli and LifePlan Assoc., Inc., 90 S.E.C. Docket 385, 2007 WL 675087, at *21 (Mar. 5, 2007) ("[A]s an investment adviser, Disraeli had an ongoing duty to his advisory clients to make full and fair disclosure of material information."); Laird v. Integrated Res., Inc., 897 F.2d 826, 837 (5th Cir. 1990) (referring to advisers' "continuous advice" (quoting *Capital Gains Research Bureau,* 375 U.S. at 187)).

174. *See supra* notes 89-110 and accompanying text.

175. *See Laird,* 897 F.2d at 836 ("[N]on-compliance with the disclosure regulations of the Investment Advisers Act does not create per se liability under rule 10(b)-5.").

176. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976) (holding that there is no private cause of action under Section 10(b) and Rule 10b-5 absent scienter).

177. *Capital Gains Research Bureau,* 375 U.S. at 195 ("Congress, in empowering the courts to enjoin any practice which operates 'as a fraud or deceit' upon a client, did not intend to require proof of intent to injure and actual injury to the client.").

178. For a discussion of liability under the Advisers Act and the Exchange Act, see *supra* notes 168-73 and accompanying text.

tween the law governing brokers and advisers and is best illustrated by a recent example.

In a series of cases, broker-dealer firms selling mutual fund shares have been sued for failing to disclose receipt of incentive payments that allegedly induced the brokers to improperly steer investors to buy certain funds. In these cases, the plaintiffs alleged that mutual fund firms paid the broker-dealers and, in return, the brokers agreed to accord those funds preference, or more prominent "shelf-space," when marketing funds to investors. The shelf space reference is an analogy to the way a manufacturer of breakfast cereals might pay a grocer for prominent shelf space in the supermarket aisle.

Plaintiffs in these cases have not met with much success. In *In re Merrill Lynch Investment Management Funds Securities Litigation*,[179] the plaintiffs alleged, among other things, that the brokers violated Exchange Act Section 10(b) and Rule 10b-5 by failing to disclose material facts about the shelf-space arrangements.[180] In its 2006 opinion, the court explained that under the law of Section 10(b), the plaintiffs must prove a material misstatement or omission, and an omission is only actionable when the defendant had a duty to disclose.[181] A duty to disclose only arises through a statute or rule or when the disclosure is material.[182] The court concluded that no statute or rule imposed a duty to disclose and the allocation of payments made to the brokers was not material.[183]

A similar case against UBS was decided two years later.[184] In that case, the court granted the defendants' motion to dismiss but tied its decision more closely to the non-fiduciary status of the broker-dealer defendants. Unlike the Merrill Lynch case, in the UBS-AG affair, the plaintiffs also alleged that a duty to disclose was created by a relationship of trust and confidence between the broker and the investors. The plaintiffs alleged that the defendants' statements concerning the possibility of entering into shelf space arrangements led to a duty to speak more truthfully, namely stating that such payments were not only possible, but that they had in fact been made.[185]

The court did not buy the trust and confidence argument. The court stated that the fiduciary relationship between a broker and its customer is limited to the narrow task of executing the transaction.[186] Thus, because

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179. 434 F. Supp. 2d 233, 237 (S.D.N.Y. 2006).

180. *See id.* at 237.

181. *Id.*

182. *See id.* at 238.

183. *See id.*; *see also In re* Morgan Stanley and Van Kampen Mut. Fund Sec. Litig., No. 03 Civ. 8208(RO), 2006 WL 1008138, at *8 (S.D.N.Y. Apr. 18, 2006) (stating that plaintiffs failed to identify the source of brokers' duty to disclose that they were compensated more for sale of certain funds than others).

184. *See* Hoffman v. UBS-AG, 591 F. Supp. 2d 522 (S.D.N.Y. 2008).

185. *See id.* at 535.

186. *See id.* at 535-36.

brokers are not fiduciaries, or are fiduciaries for execution purposes only, the conflict of interest inherent in a shelf-space arrangement did not have to be disclosed.[187] This ruling is consistent with the discussion above regarding the episodic versus the ongoing nature of the broker's relationship with the customer. As to the argument about speaking truthfully (disclosing that payments were not only possible but had in fact been made), the court rejected the claim that *all* information about the brokers' compensation must be disclosed. Statements made to investors did not create an impression materially different from the truth.[188]

In one case where the plaintiffs prevailed, the argument about disclosing the fact that payments were actually made, as opposed to merely possible, won the day. In *Siemers v. Wells Fargo & Co.*,[189] the plaintiffs prevailed at the motion-to-dismiss stage.[190] Notably, this court did not rule on fiduciary grounds. Rather, the court stated that an important difference exists between a situation where a fund *may* make certain payments in the hope of obtaining future sales, and a situation where a fund *has already made* such payments.[191] The disclosures, the court said, only hinted at the *possibility* of kickbacks as opposed to telling investors about the arrangement *already in place* and its attendant conflict of interest.[192]

c. Principal Transactions

Although more technical than the two points mentioned above, perhaps the most significant difference between the duties owed by brokers as opposed to advisers stems from the restrictions on principal transactions.[193] Under Section 206(3) of the Advisers Act, an adviser is strictly prohibited from trading securities out of its own account with a client unless the adviser provides advance written disclosure to the client and obtains consent.[194] Consent must be obtained on a trade-by-trade basis; therefore, a blanket waiver is not valid.[195] Brokers face no such restriction and regularly sell securities from their own accounts to their customers.

The importance of principal trading should not be understated. Broker-dealers administer a thriving principal market in securities, engaging

187. *Id.* at 535.

188. *See id.*

189. No. C 05-04518 WHA, 2006 WL 2355411 (N.D. Cal. Aug. 14, 2006).

190. *See id.*

191. *See id.* at *5.

192. *See id.* at *7.

193. For a further discussion of the duties imposed on brokers and advisors, see *supra* notes 163-92 and accompanying text.

194. For a further discussion of the Advisers Act, see *supra* note 6 and accompanying text.

195. *See* Opinion of Director of Trading and Exchange Division, Investment Advisers Act Release No. 40, 11 Fed. Reg. 10,997 (Feb. 5, 1945) (requiring consent before each trade).

in thousands or tens of thousands of principal trades each day.[196] Principal trading has been a significant part of brokers' business since before the passage of the federal securities laws. The 1930s Congress debated whether to separate the functions of brokers and dealers and determined not to do so.[197] The NASD, now FINRA, developed an entire body of rules to govern the price a broker may charge when transacting with a customer.[198]

In addition, broker-dealers engage in securities underwritings by assisting issuers to sell their securities to the public. In that capacity, the firms might advise the underwriting client on the type of security to be sold and the timing of the offer, and it might help prepare the issuer to be more attractive to potential investors.[199] In some instances, the offering is accomplished on a "firm commitment" or "purchase agreement" basis, whereby the broker-dealer commits to purchasing the shares from the issuer and then tries to resell them to the public, including its own customers.[200]

Thus, the difference between brokers and advisers transcends the issue of whether and when brokers owe a fiduciary duty to customers. Answering that question ignores the business and the cultural variations between them. The fact that a fiduciary duty generally is not owed by broker-dealers is evidence of a more fundamental characteristic of their business model. Broker-dealers transact with their customers as principals and, when doing so, cannot readily act in their customers' best interest. Advisers are poles apart. Other than negotiating a fee, advisers typically are not in an adversarial posture with their clients and can adhere more easily to the best interest standard. These differences create a deep tension that must be addressed before imposing a fiduciary duty on brokers that give advice.[201]

Although courts and commentators are not of one mind, generally speaking, in the case of a non-discretionary account, brokers are not held

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196. *See* Temporary Rule Regarding Principal Trades with Certain Advisory Clients, Advisers Act Release No. 2653, 72 Fed. Reg. 55,022, 55,024 (Sept. 27, 2007).

197. *See* Laby, *supra* note 13, at 426-27.

198. *See* NASD Rule 2440, *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3660 (requiring price to be "fair, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that he is entitled to a profit . . . ."); *see also* NASD Rule IM-2440-1, *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3661 (describing five percent mark-up policy as guide for broker-dealers).

199. *See* JAMES D. COX, ROBERT W. HILLMAN & DONALD C. LANGEVOORT, SECURITIES REGULATION: CASES AND MATERIALS 118 (6th ed. 2009).

200. *See* CHARLES J. JOHNSON & JOSEPH MCLAUGHLIN, CORPORATE FINANCE AND THE SECURITIES LAWS 65-66 (3d ed. 2004).

201. For a discussion of the tension regarding fiduciary duties on brokers, see Laby, *supra* note 13, at 424-34 and accompanying text.

to fiduciary standards, except perhaps in the narrow task of executing a trade. By contrast, advisers are typically held to a federal fiduciary standard due to the antifraud provision of the Advisers Act and the Supreme Court's gloss in the *Capital Gains* case. Brokers, however, have robust duties of their own, including obligations under the general heading of "suitability" and "know your customer" obligations which also apply to advisers. For non-discretionary accounts, however, brokers' duties tend to be intermittent, while advisers' duties tend to be ongoing—extending to dormant periods of inactivity in the customer's account. During these periods, a typical stockbroker owes no duty to the customer while an adviser acts more like a protective guardian and has a positive duty to act should market conditions or the client's circumstances call for a change.

IV. FIDUCIARY DUTIES FOR BROKERS GIVING ADVICE

This last Part addresses whether fiduciary duties should be imposed on brokers that provide advice. In 2005, the SEC recognized the importance of this issue, calling for a study regarding whether brokers that provide advice should be subject to fiduciary obligations normally imposed on advisers.[202] This is precisely the question taken up in the Obama Administration's 2009 White Paper[203] and in the Dodd-Frank Wall Street Reform Act.[204]

Although brokers have always provided advice, that component of their services did not predominate at the time the Advisers Act was passed. In recent years, however, advice has displaced transaction execution as a chief activity carried out by brokers. It comes as no surprise that today brokers market themselves as financial advisers rather than stockbrokers. This change in emphasis from execution to advice as a primary feature of a broker's business represents a change in circumstances for the brokerage industry and justifies the imposition of fiduciary duties.

A. *Historical Trends*

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. *The Security Market* study referenced above explained that in the 1930s, a brokerage firm's relationship with a

202. *See* Certain Broker-Dealers Deemed Not to Be Investment Advisers, Exchange Act Release No. 51,523, Advisers Act Release No. 2376, 70 Fed. Reg. 20,424, 20,442 (Apr. 19, 2005) (proposing study that would address whether "broker-dealers who provide investment advice but who are excepted from the Investment Advisers Act [should] nonetheless be subject to the fiduciary obligations imposed by that Act on investment advisers").

203. *See* DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM, A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION 71 (2009).

204. For a discussion of the Dodd-Frank Act, see *supra* note 12 and accompanying text.

customer had four aspects.[205] First, it acted as a broker in the purchase and sale of securities and in borrowing and lending stocks. Second, it acted as a pledgee, lending its own capital to the customer or advancing capital borrowed from banks. Third, it was the custodian of the customer's cash and securities. Fourth, it exercised, "to some extent," the function of investment counsel. The advice component is last on the list and qualified in scope.[206] 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.[207] Open a modern description of the activities of broker-dealers and advice often is paramount.[208]

A primary reason for this shift is technology.[209] In the early part of the twentieth century, transaction execution was difficult to accomplish. Today, advances in technology have reduced the time and cost to process trades.[210] As a result, the advice component of brokerage business has eclipsed transaction execution in importance. When asked which professional services matter most, survey responders chose retirement planning, investment advising, financial planning, and estate planning over executing stock or mutual fund transactions and other possible responses.[211]

Understanding that the function of brokerage has evolved, helps place the broker-dealer exclusion in the Advisers Act in historical context.[212] Although brokers provided some advice when the Advisers Act was passed, as long as advice was not the primary service offered to investors—that is, as long as the advice was "solely incidental" to brokerage services performed—the broker was excluded from the definition of ad-

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205. *See* TWENTIETH CENTURY FUND, *supra* note 125, at 673.

206. *See id.*

207. *See* EDWIN J. PERKINS, WALL STREET TO MAIN STREET: CHARLES MERRILL AND MIDDLE-CLASS INVESTORS 69, 71 (1999).

208. *See* RALPH S. JANVEY, REGULATION OF THE SECURITIES AND COMMODITIES MARKETS ¶¶ 4.01-4.02 (1992) (explaining that broker-dealers provide services throughout execution process including research and advice, price discovery and execution, delivery and payment, and custody); BURTON G. MALKIEL, A RANDOM WALK DOWN WALL STREET (1990) (explaining that most important feature when choosing a broker is quality of research).

209. *See* Laby, *supra* note 13, at 422-24.

210. *See* JAMES J. ANGEL, LAWRENCE E. HARRIS & CHESTER S. SPATT, EQUITY TRADING IN THE 21ST CENTURY 4 (2010), *available at* http://www.knight.com/newsRoom/pdfs/EquityTradinginthe21stCentury.pdf ("Automation gradually transformed the market from a human-intermediated market to a computer-intermediated market with little human interaction or real-time oversight.").

211. *See* RAND REPORT, *supra* note 1, at 104-05; *see also* BENJAMIN GRAHAM, THE INTELLIGENT INVESTOR 261 (Jason Zweig ed., 2003) ("Probably the largest volume of information and advice to the security-owning public comes from stockbrokers.").

212. For a further discussion of the Advisers Act and evolution of the function of a broker, see *supra* notes 111-158 and accompanying text.

viser and the Advisers Act's fiduciary standard was not imposed.[213] The decision to exclude brokers that provide advice from the Advisers Act may have been appropriate in 1940 when advice was a minor ingredient in the services provided. Today, however, brokers' functions have changed and advice is more central.[214]

Why then did some nineteenth and early twentieth century courts hold that brokers were fiduciaries? The reason had little to do with the advisory function performed today.[215] Cases that labeled brokers as fiduciaries centered more on execution or custody—non-advisory-related services—than on the provision of advice.[216] Today, however, cases addressing whether brokers are fiduciaries focus heavily on the broker's advisory function. The question often presented is whether an investor has placed sufficient trust and confidence in the brokerage firm to justify the imposition of fiduciary obligations.[217] The trust and confidence referred to, however, is trust and confidence in the broker's advice.[218]

This shift in reported cases is consistent with the transformation in brokerage services. As advice overtook execution in importance, the case law similarly began to address whether reliance on a broker's advice called for the imposition of fiduciary duties. The SEC recognized this development in its discussion of whether broker-dealers are fiduciaries. When the SEC adopted its 2005 exemptive rule, it noted that in some cases when

213. *See* Investment Advisers Act of 1940 § 202(a)(11)(C), 54 Stat. 847 (codified at 15 U.S.C. § 80b-2(a)(11)(C) (2006)). The exclusion also contained a requirement that the broker's compensation must be limited to commissions. *Id.*

214. *See* Temporary Rule Regarding Principal Trades with Certain Advisory Clients, Advisers Act Release No. 2653, 72 Fed. Reg. 55,022, 55,022 (Sept. 28, 2007) ("Fee-based brokerage accounts are similar to traditional full-service brokerage accounts, which provide a package of services, including execution, incidental investment advice, and custody."); *see also* Donald C. Langevoort, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets*, 95 VA. L. REV. 1025, 1049 (2009) (describing brokers' use of "trust-based selling techniques, offering advice" as "core" of full-service brokerage).

215. For a further discussion of brokers as fiduciaries and their advisory action, see *supra* notes 115-39.

216. *See supra* notes 124-25.

217. For a further discussion of the fiduciary obligations imposed on brokerage firms, see *supra* notes 140-58.

218. *See, e.g.*, MidAmerica Fed. Sav. & Loan Assoc. v. Shearson/American Express Inc., 886 F.2d 1249, 1258 (10th Cir. 1989) (explaining that fiduciary relationship arose in context of trust reposed in Shearson as to information regarding GNMA unit trust transactions); Paine, Webber, Jackson & Curtis, Inc. v. Adams, 718 P.2d 508, 517, 518 (Colo. 1986) (explaining that trust arose in context of management of account); Leib v. Merrill Lynch, Pierce, Fenner & Smith, 461 F. Supp. 951, 954-55 (E.D. Mich. 1978) (explaining that discussions of prudence of particular transactions bears on whether broker controls account, which bears in turn on presence of fiduciary relationship), *aff'd*, 647 F.2d 165 (6th Cir. 1981).

broker-dealers assume a position of trust and confidence akin to that of advisers, they have been held to fiduciary standards.[219]

B. *Fiduciary Duties*

1. *The Advisory Function*

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."[220] Moreover, scholars examining fiduciary relationships have noted that they typically arise when two elements are present—when the principal reposes some discretion in the agent and when the agent has the ability to affect the legal position of the principal.[221] The twin purposes of the fiduciary duty are to limit the fiduciary's discretion[222] and to help ensure that the fiduciary acts to serve the principal's ends.[223]

These precepts can be applied readily to broker-dealers dispensing advice. When a customer turns to a broker for advice, the customer reposes discretion in the broker to provide appropriate guidance and direction. Moreover, the broker has the ability to affect the customer's legal

219. *See* Certain Broker-Dealers Deemed Not to Be Investment Advisers, Exchange Act Release No. 51,523, Advisers Act Release No. 2376, 70 Fed. Reg. 20,424, 20,433 (Apr. 19, 2005).

220. RESTATEMENT (SECOND) OF TORTS § 874 cmt. a (1979) (citation omitted) (emphasis added); RESTATEMENT (FIRST) OF TORTS § 874 cmt. a (1939) (citation omitted) (emphasis added).

221. *See* Ernest J. Weinrib, *The Fiduciary Obligation*, 25 U. TOR. L.J. 1, 4 (1975) ("Two elements thus form the core of the fiduciary concept and these elements can also serve to delineate its frontiers. First, the fiduciary must have scope for the exercise of discretion, and, second, this discretion must be capable of affecting the legal position of the principal."); *see also* Lawrence E. Mitchell, *Trust, Contract, Process.*, *in* PROGRESSIVE CORPORATE LAW 185, 188-89 (Lawrence E. Mitchell ed., 1995) (differentiating fiduciary relationships by discretion vested in fiduciary and lack of control on part of principal); D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1402 (2002) (stating that fiduciary duties arise when one person acts on behalf of another and exercises discretion over the other's critical resource) (emphasis omitted).

222. *See* Varity Corp. v. Howe, 516 U.S. 489, 504 (1996) (explaining that "primary function" of fiduciary obligation is to "constrain the exercise of discretionary powers"); *see also* Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 915 (stating that "only general assertion" that can be made about fiduciary duties is that they are devices to "control one's discretion"); Tamar Frankel, *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209, 1223 (1995) ("[T]he main purpose of fiduciary law is to reduce entrustors' risk from embezzlement of their entrusted property or interests, and to reduce the costs of monitoring fiduciaries."); Weinrib, *supra* note 221, at 4 ("The fiduciary obligation is the law's blunt tool for the control of this discretion.").

223. *See* Laby, *supra* note 58, at 129-30 (arguing that signature obligation of fiduciary is to adopt ends of his or her principal).

position, either directly, in the case of a discretionary account, or indirectly, in the case of a non-discretionary account, assuming the customer accepts the advice. The furnishing of advice therefore calls for the imposition of fiduciary duties.

2. *The Need for Fiduciary Protections*

Because advice has eclipsed execution as the primary service performed by broker-dealers, advice can no longer be considered "solely incidental" to brokerage. Indeed, it is brokerage that appears to be solely incidental to advice. In the 1980s, to better compete with investment advisers, many brokerage firms began to offer financial planning services and shun the title of stockbroker.[224] Instead, broker-dealer registered representatives began to label themselves as financial advisors, financial consultants, financial representatives, and investment specialists.[225] These titles imply that the individual is not acting at arm's length. They are meant to induce a customer to repose trust in the professional as a neutral source of research and recommendations. Because advice is such an important part of a broker's activity, and because dispensing advice calls for the imposition of fiduciary duties, brokers that give advice should be subject to fiduciary obligations.[226]

To understand why imposing fiduciary duties would promote investor protection, it is important to reflect momentarily on the nature of the fiduciary obligation and consider what it is designed to achieve. The fiduciary obligation comprises two separate duties—the duty of loyalty and the duty of care—each fulfilled by conduct of a different character. The duty of loyalty is primarily a negative duty against self-dealing or other deceitful conduct. According to the *Restatement (Third) of Trusts*, the duty of loyalty entails a strict prohibition on entering into transactions involving trust property if the transaction is for the trustee's personal account or otherwise creates a conflict of interest between the trustee's fiduciary duties and personal interest.[227] The *Restatement (Third) of Agency* dictates that the duty of loyalty is a duty to not obtain a benefit through actions taken for the principal or to otherwise benefit through use of the fiduciary's position.[228]

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224. *See* Letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America, to Jonathan G. Katz, Secretary, SEC (Sept. 24, 2004) (on file with author).

225. *See* RAND REPORT, *supra* note 1, at 74.

226. For a discussion of the objections to placing fiduciary duties on brokers, see Laby, *supra* note 13, at 424-39 and accompanying text.

227. *See* RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. a (2007) (stating that duty of loyalty "strictly prohibits the trustee from entering into transactions involving the trust property, or affecting its investment or management, if the transaction is for the trustee's personal account (self-dealing) or otherwise involves or creates a conflict between the fiduciary duties and personal interests of the trustee . . . unless authorized").

228. *See* RESTATEMENT (THIRD) OF AGENCY § 8.02 cmt. a (2006) (explaining that under duty of loyalty, "an agent has a duty not to acquire material benefits in

This general approach holds true in the fiduciary law of investment advisers. The duty of loyalty, for example, prohibits an adviser from taking an investment opportunity for him or herself before offering it to clients.[229]

In contrast to the negative character of the duty of loyalty, the duty of care requires affirmative conduct on the principal's behalf. The duty of care is a duty of attention, requiring the exercise of reasonable effort and diligence, and ongoing monitoring of the principal's situation with an eye toward achieving her interests and objectives.[230] The duty of care entails collection of relevant information and investigation into what action is appropriate under the circumstances.[231] In the corporate governance area, reasonable care requires active participation from directors to keep informed and determine whether corporate conduct is legal.[232] The *Restatement (Third) of Agency* articulates an analogous duty to interpret the principal's manifestations to ascertain the principal's objectives and act accordingly.[233]

The provision of advice is the type of activity where agency costs are high and, therefore, fiduciary protections are needed most. It can be difficult ex post to determine the wisdom of an investment recommendation at the time it was made. A decision to recommend one investment over another is based on many factors; one can seldom know if self-interest was a motivating force. The imposition of the fiduciary duty of loyalty and the regulation of conflicts are ways to control the risk that an investment recommendation will not be objective. By requiring the broker to fully dis-

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connection with transactions or other actions undertaken on the principal's behalf or through the agent's use of position").

229. *See In re* Joan Conan, Advisers Act Release No. 1446, 57 S.E.C. Docket 1952, 1994 WL 549000, at *3 (Sept. 30, 1994) ("As a fiduciary and agent, an investment adviser owes her clients a duty of loyalty, which, among other things, requires an adviser to offer her clients investment opportunities before taking such opportunities for herself.").

230. *See* RESTATEMENT (THIRD) OF TRUSTS § 77 cmt. b (2007) ("The duty of care requires the trustee to exercise reasonable effort and diligence in planning the administration of the trust, in making and implementing administrative decisions, and in monitoring the trust situation, with due attention to the trust's objectives and the interests of the beneficiaries.").

231. *See id.* ("[The duty of care] will ordinarily involve investigation appropriate to the particular action under consideration, and also obtaining relevant information about such matters as the contents and resources of the trust estate and the circumstances and requirements of the trust and its beneficiaries.").

232. *See, e.g.*, Lean v. Reed, 876 N.E.2d 1104, 1111 (Ind. 2007) ("[P]laintiffs have established that Lean knew, or in the exercise of reasonable care could have known, that the disputed transaction involved the unlawful issuance of unregistered securities."); Francis v. United Jersey Bank, 432 A.2d 814, 822 (N.J. 1981) ("Directors are under a continuing obligation to keep informed about the activities of the corporation.").

233. *See* RESTATEMENT (THIRD) OF AGENCY § 2.02 cmt. f (2006) ("The agent's fiduciary duty to the principal obliges the agent to interpret the principal's manifestations so as to infer, in a reasonable manner, what the principal desires to be done in light of facts of which the agent has notice at the time of acting."); *see generally*, Laby, *supra* note 58, at 130-37.

close conflicts and potential conflicts—much like the adviser was required to disclose its scalping in the *Capital Gains Research Bureau* case—the investor can disentangle the factors bearing on a recommendation.[234]

In addition, establishing a fiduciary duty of care for brokers would guard against the failure to take sufficient initiative on a customer's behalf. The fiduciary duty of care comprises a duty of attention and action. A fiduciary cannot sit on his hands and spring into action only when harm may befall the principal. Assuming the advisory relationship was ongoing, the adviser must consider the interests of the principal, monitor his or her situation, and take affirmative steps to advance his or her interests.[235]

If a broker holds itself out as an adviser and suggests it is seeking a long-term relationship with the customer, a fiduciary duty imposed on the broker would be broader in scope than the broker's current obligation. State courts generally have not allowed recovery for negligent investment advice and construe a broker's responsibility to a customer narrowly.[236] A federal fiduciary duty under these facts would be ongoing in nature regardless of whether trading is occurring, requiring the broker to pay close attention to the customer's account. This proposal does not represent a significant change. The content outline for the Series 7 exam, taken by registered representatives of broker-dealer firms, includes seven critical functions, the last of which is monitoring the customer's portfolio and recommending changes consistent with economic and financial conditions and the customer's needs.[237] Thus, although the courts have not endorsed this ongoing duty, FINRA examiners appear to be in agreement.

3. *Compensatory Schemes*

During the 1990s, many brokers began to migrate from a commission-based fee system to an asset-based system.[238] Charging asset-based fees was

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234. *See* SEC v. Capital Gains Research Bureau, 375 U.S. 180, 196 (1963) (explaining that investors have need to sort out "overlapping motivations" of adviser through disclosure, particularly if one of motivations is self-interest).

235. An ongoing duty to monitor should be an obligation the parties could agree renegotiate if they choose. *See* Barbara Black, *Fiduciary Duty, Professionalism and Investment Advice* 4 (Univ. of Cin. College of Law Pub. Law & Legal Theory Research Paper Series, Paper No. 10-24, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1579719).

236. *See* Barbara Black, *Transforming Rhetoric into Reality: A Federal Remedy for Negligent Brokerage Advice*, 8 TRANSACTIONS: TENN. J. BUS. L. 101, 114 (2006) ("[C]ourts are reluctant to impose negligence liability on securities brokers for failure to adhere to industry standards.").

237. *See* CONTENT OUTLINE FOR THE GENERAL SECURITIES REGISTERED REPRESENTATIVE EXAMINATION (TEST SERIES 7) 3 (1995), *available at* http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/industry/p038201.pdf.

238. *See* Certain Broker-Dealers Not Deemed to Be Investment Advisers, Exchange Act Release No. 42,099, Advisers Act Release No. 1845, 64 Fed. Reg. 61,226, 61,227 (proposed Nov. 4, 1999) ("[S]everal full service brokerage firms have introduced or announced new types of [fee-based] brokerage programs.").

a way for brokers to stabilize their revenue, which fluctuated depending on the amount of trading in a commission account. At the same time, regulators were concerned with "churning" in a customer's account, recommending a trade for the sole purpose of earning a commission.[239] As a result, they encouraged the use of asset-based fees, which remove the incentive to generate commissions. Much of the debate over whether brokers should be deemed fiduciaries has focused on brokers that charge an asset-based fee. This is because receipt of asset-based fees would be considered "special compensation" under the Advisers Act and rule out application of the broker-dealer exclusion. This type of compensation, however, should not be the sole driver as to whether brokers owe fiduciary duties.

A fiduciary duty should be imposed on a broker providing advice regardless of the method of compensation employed. Customers who pay commissions need fiduciary protections to guard against opportunism that may arise in any commission-based business. In the world of securities brokerage, a common risk in a commission-based account is the risk of churning, where a broker makes excessive recommendations.[240] Customers who pay an asset-based fee are equally in need of protection. An asset-based fee, although reducing the likelihood of churning, increases the chance that a broker-dealer will ignore a customer's account—aptly called "reverse churning"—because the firm will be paid regardless of whether a transaction occurs.[241] In a fee-based account, regulators are concerned about "opportunism by neglect"—inattention and indifference to the account.[242] Payment of a fixed asset-based fee provides disincentives to monitor, which results in neglected customers who receive little or no advice and seldom trade even when transactions are called for.

Thus, the two-fee structures—commissions and asset-based fees—give rise to a peculiar dialectic. If one tries to reduce churning, the danger of reverse churning arises. Attempts to eliminate reverse churning lead back to commission-based compensation with the attendant dangers mentioned. The dilemma posed by these twin fee structures is not unique to

239. *See* DANIEL P. TULLY ET AL., REPORT OF THE COMMITTEE ON COMPENSATION PRACTICES (1995), *available at* http://www.sec.gov/news/studies/bkrcomp.txt (concluding that firms should base some of registered representative's compensation on assets held in account regardless of whether transactions occur).

240. *See* Mihara v. Dean Witter & Co., 619 F.2d 814, 820 (9th Cir. 1980); *see also* Applicability of Broker-Dealer Regulation to Banks, Exchange Act Release No. 22,205, 50 Fed. Reg. 28,385, 28,390 (July 12, 1985) (explaining that payment of commissions can lead to churning).

241. *See* THOMAS P. LEMKE & GERALD T. LINS, REGULATION OF INVESTMENT ADVISERS § 2:116 (2010) ("[C]oncern has been expressed that wrap fees may give rise to 'reverse churning' (i.e., a lack of trades in an account that otherwise would have been made had the client been paying separate commissions for them).").

242. *See* Press Release, Fin. Indus. Regulatory Auth., FINRA Fines Robert W. Baird & Co. $500,000 for Fee-Based Account, Breakpoint Violations (Feb. 18, 2009) (criticizing firm for allowing customers to remain in fee-based accounts although they did no trading for two-year period).

financial services. Health care is a good analogy. When discussing health services, the U.S. Supreme Court has explained that in a fee-for-service system, akin to a "pay-as-you-go" commission-style arrangement, the physician's financial incentive is to provide more care, not less, as long as the patient is paying his bills. Over-treatment is the trouble.[243] By contrast, in a pre-payment system such as a health maintenance organization (HMO), akin to an asset-based fee in financial services, the physician's incentive is to provide less care, not more. The fear is under-treatment.[244]

Prescribing fiduciary duties for broker-dealers that hold themselves out as advisers also would help resolve the dilemma imposed by the twin methods of remuneration. First, imposing a fiduciary duty would be an additional weapon to combat churning in a customer's account. Churning is a form of self-dealing—a way for a broker to effectively misappropriate funds from the client's account for the broker's benefit. The fiduciary duty of loyalty guards against this type of conduct and would enable a customer to combat it by bringing a cause of action under fiduciary principles, including a state common law claim for breach of fiduciary duty. Although the Exchange Act requires a plaintiff to show scienter,[245] a common law breach of fiduciary duty claim typically requires showing only existence of the duty, breach, causation, and resulting damages.[246]

Second, imposing a fiduciary duty of care would protect investors in fee-based accounts from paying ongoing monthly or quarterly fees while receiving little or no value in return. The duty of care requires the broker to pay attention to the account and analyze the customer's needs on an ongoing basis.

This Part explains why brokers giving advice should be subject to fiduciary duties. The nature of brokerage services has changed significantly since the time the broker-dealer exclusion was passed in the 1940s. Though at one point it may have been appropriate to allow brokers to provide advice incidental to brokerage without the obligations imposed on advisers, the exclusion is no longer applicable because providing investment advice looms as the more significant aspect of a broker's activity. Moreover, both types of remuneration brokers receive—commissions and asset-based fees—call for the introduction of fiduciary duties. The twin duties of loyalty and care offer a synergy to address the particular problems that result from both forms of compensation.

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243. *See* Pegram v. Herdrich, 530 U.S. 211, 218 (2000).

244. *See id.* at 219.

245. *See supra* note 176 and accompanying text.

246. *See, e.g.*, Peirce v. Lyman, 3 Cal. Rptr. 2d 236, 240 (Cal. Ct. App. 1991) ("In order to plead a cause of action for breach of fiduciary duty, there must be shown the existence of a fiduciary relationship, its breach, and damage proximately caused by that breach."); Jones v. Blume, 196 S.W.3d 440, 447 (Tex. App. 2006) ("The elements of a breach of fiduciary duty claim are: (1) a fiduciary relationship between the plaintiff and defendant; (2) the defendant must have breached his fiduciary duty to the plaintiff; and (3) the defendant's breach must result in injury to the plaintiff or benefit to the defendant.").

V. CONCLUSION

The financial crisis of 2008 has triggered a national debate over the proper regulation of financial services providers. The Dodd-Frank financial reform legislation includes enhanced regulation over insured depository institutions, bank holding companies, credit rating agencies, hedge fund advisers, OTC derivatives, insurance firms, mortgage lenders, and others.[247] Harmonization of the law governing broker-dealers and investment advisers, and a decision to place a fiduciary duty on brokers providing advice, is one component of a larger reform agenda.

Before moving forward with reform, one can reflect on the essential questions that should precede any change in the law—namely, what are the relevant rules applicable today, and what is the basis for change? These are vexatious issues with respect to the duties imposed on brokers and advisers. Even before the advent of the federal securities laws, courts did not agree on whether and under what circumstances brokers owe fiduciary duties to customers. Today, the general consensus is that a broker with discretionary trading authority over a customer account is subject to fiduciary obligations, whereas a broker without discretionary power is not a fiduciary. This general rule, however, is subject to numerous exceptions. A regulatory fiat declaring brokers that give advice to be fiduciaries to their customers would diminish the confusion in this area of the law.

Before implementing such a change, policymakers are considering whether it is justified. Should all brokers offering advice be held to a fiduciary standard? This question can be approached from a historical perspective. Starting in 1940, many brokers that provided advice were excluded from application of the Advisers Act and the attendant fiduciary duties imposed on advisers as long as the broker's advice was solely incidental to brokerage. Although the solely incidental exclusion worked well for several decades, the relative roles and responsibilities of brokers have transformed. Today advice is an essential ingredient of a broker's financial services, rendering the solely incidental exclusion no longer applicable and justifying a fiduciary duty for brokers providing advice.

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247. *See supra* note 12 and accompanying text.