Case No. 18-3689

IN THE UNITED STATES COURT OF
APPEALS FOR THE EIGHTH CIRCUIT

GERALD J. KLEIN, on behalf of himself and
all similarly situated, Plaintiff

RODERICK FORD,
Plaintiff-Appellee

v.

TD AMERITRADE HOLDING CORPORATION; TD AMERITRADE, INC.;
FREDRIC J. TOMCZYK,
Defendants-Appellants

On appeal from the United States District Court for the District of Nebraska
Case No. 8:14-cv-00396 (Judge Joseph F. Bataillon)

BRIEF AMICUS CURIAE, BY CONSENT, OF BETTER MARKETS, INC. IN
SUPPORT OF THE PLAINTIFF-APPELLEE AND AFFIRMANCE

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure ("FRAP"), Better Markets states that it has no parent corporation and there is no publicly held corporation that owns any stock in Better Markets.

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STATEMENT OF IDENTITY, INTEREST, AND AUTHORITY TO FILE OF BETTER MARKETS[1]

Better Markets, Inc. ("Better Markets") is a nonprofit, nonpartisan organization that promotes the public interest in the financial markets through comment letters on proposed rules, litigation, independent research, and public advocacy. It fights for regulatory reforms that create a stronger, safer financial system for the benefit of all Americans. It also advocates for reforms that protect individual investors from fraud, abuse, and conflicts of interest, and it seeks to ensure that investors who are victimized by brokers, financial advisers, or banks have meaningful remedies. *See generally* Better Markets, http://www.bettermarkets.com (including archive of comment letters, briefs, and other materials).

Better Markets' advocacy has focused significantly on the important role of class action litigation as the most effective, and often the only, mechanism that can afford meaningful remedies to investors harmed by fraud, abuse, and conflicts of interest. Specifically, Better Markets has fought to preserve investors' right to bring class action claims where financial institutions have engaged in widespread

[1] In accordance with FRAP 29(a)(4)(E), Better Markets states that (i) no counsel for any party authored this brief in whole or in part; (ii) no party or party's counsel contributed money that was intended to fund preparing or submitting this brief; and (iii) no person—other than Better Markets, its members (of which there are none), or its counsel—contributed money that was intended to fund preparing or submitting this brief. Pursuant to FRAP 29(a)(2) and 29(a)(4)(D), Better Markets states that all parties have consented to the filing of this amicus brief.

misconduct that victimizes a broad swath of the public in comparatively small increments. *See, e.g.,* Better Markets Comment Letter to Consumer Financial Protection Bureau (Aug. 22, 2016), *available at* https://bettermarkets.com/sites/default/files/CFPB-%20CL%20-%20Arbitration%20Agreements-%208-22-16%20%28Searchable%29.pdf (supporting arbitration rule that protected consumers' right to participate in class actions); Better Markets, *The Fight for CFPB Arbitration Rule Is About Ensuring Consumers Can Hold Big Banks Accountable* (Sept. 26, 2017), https://bettermarkets.com/blog/fight-cfpb-arbitration-rule-about-ensuring-consumers-can-hold-big-banks-accountable (reviewing data highlighting the shortcomings of arbitration relative to litigation for consumers); Brief of AARP, Better Markets, and other organizations as Amici Curiae in Support of Defendants, *Thrivent Financial for Lutherans v. Perez*, No. 16-cv-03289-SRN-HB (D. Minn. Dec. 9, 2016), *available at* https://www.aarp.org/content/dam/aarp/aarp_foundation/litigation/pdf-beg-02-01-2016/thrivent-v-perez.pdf. (arguing in favor of a rule allowing investors harmed by widespread or systemic conflicts of interest to seek relief in court via class actions).

Better Markets has an interest in seeking affirmance in this case because the district court's class certification ruling protects and preserves the right of thousands of investors to pursue damages for the Defendants' alleged widespread breach of their fiduciary duty to seek the best execution of their clients' trading orders. The Plaintiff contends that the Defendants consistently placed their own interest in maximizing incentive payments from exchanges over their clients' interest in obtaining the best execution of their trades. This pattern of misconduct allowed them to reap millions of dollars in payments for order flow, while inflicting huge collective harm on their clients. Due to the scale of injury to each individual client, no single plaintiff could or would be in a position to seek relief through individual litigation (or arbitration), given the enormous expense of such an undertaking. Therefore, without the class action remedy, thousands of investors would be left with no meaningful avenue of redress. Moreover, the Defendants would retain hundreds of millions of dollars in ill-gotten gains, a profoundly inequitable result. And the powerful deterrent effect of the class action remedy would be lost, likely resulting in additional patterns of misconduct by the Defendants and other firms that bleed away the savings of everyday investors.

The district court's decision warrants support not only because it allows victims to pursue relief, but also because it correctly rejects a number of meritless legal defenses that are likely to recur in similar cases. Of particular importance is the court's holding that the Plaintiff's experts have developed an algorithm that can ascertain economic losses reliably and efficiently on a classwide basis. As our securities markets continue to grow in complexity, plaintiffs seeking relief for trading abuses will increasingly need to rely on technology to prove the elements of their claims. The district court appropriately refused to countenance the Defendants' double standard, one that exalts technology when it is used to generate trading profits but disparages its reliability when it is used by plaintiffs seeking fair compensation for fraud and abuse. Equally important, the court correctly recognized that the presumption of reliance is appropriate when a fiduciary breaches its affirmative obligation of full and fair disclosure, quite apart from the degree to which the fiduciary may also have made misrepresentations to its clients. Better Markets seeks affirmance of these holdings so that the class action remains viable and so that these fundamental legal principles are upheld.

SUMMARY OF ARGUMENT

Today's stock markets are a complex and opaque web of trading venues, highly dependent on technology and largely hidden from public view and understanding. As such, they create rich opportunities for sophisticated market participants to exploit unsuspecting investors on a grand scale, to reap enormous profits in the process, and to do so through trading practices that escape notice in the arcane world of trade execution. One such brokerage practice is at issue here: the routing of client orders to exchanges solely or primarily to maximize incentive payments from those exchanges rather than to achieve best execution for the benefit of investors. This practice violates the fiduciary duty that every broker, as agent, indisputably owes to its customer. The resulting profits to brokers are prodigious, as are the damages suffered collectively by investors, even if individual losses are modest in relation to the expense of litigation.

Ensuring the availability of the class action to address such widespread and abusive practices is essential. First and foremost, it is the only mechanism that enables victims to seek and receive fair compensation for wrongs committed where, as here, individual lawsuits would be far too costly to pursue, given the typical scale of harm per investor. Class litigation is also necessary to expose abusive practices that would otherwise remain hidden, especially in the complex world of trading on the securities markets. In addition, the class action serves as a deterrent by helping eliminate the gross injustice created whenever a bad actor walks away with their ill-gotten gains simply because no effective remedy exists that might hold them to account. Finally, preserving a mechanism that provides fair compensation for victims of fraud, prevents unjust enrichment, and deters harmful market practices more broadly is essential for maintaining confidence in the integrity of our capital markets, without which they cannot thrive.

The Court's decision in this case will determine the continued availability of class actions where bad actors have consistently and repeatedly violated their fiduciary duty of best execution. By affirming the district court's class certification, the Court will ensure that investors have meaningful recourse for those violations. By contrast, if the Court accepts the Defendants' misplaced and legally erroneous contentions, especially those focused on the elements of economic loss and reliance, the Court would make class actions unavailable for investors to remedy violations of the duty of best execution, functionally rendering that duty a dead letter.

The Court should reject Defendants' arguments and preserve the vitality of the class action remedy. As to the Defendants' "economic loss" argument, the Defendants seek refuge in the ironic notion that while cutting edge technology is fine for developing innovative trading systems and generating handsome profits, that same technology is too crude and unreliable in the hands of plaintiffs seeking redress in best execution cases. But as the district court correctly held, and as Plaintiff further demonstrates in his brief on appeal, the algorithm developed by the Plaintiff's seasoned experts is well up to the task of accurately and efficiently making damages assessments across all class members. And as to the presumption of reliance, the Court can reaffirm the time-honored principle that those owing a fiduciary duty have a separate and distinct obligation to disclose all material information regarding the relationship or transaction at issue. That duty, when breached as alleged in this case, amply supports the presumption of reliance under *Affiliated Ute* regardless of the degree to which the fiduciary may also have made affirmative misrepresentations. The Court should affirm the district court on these and all other issues supporting the certification of the class in this case.

ARGUMENT

I. PAYMENTS FOR ORDER FLOW CREATE INTENSE CONFLICTS OF INTEREST, WHICH CAN LEAD TO RAMPANT VIOLATIONS OF LAW, OVERWHELM A FIDUCIARY'S DUTY OF LOYALTY, AND CAUSE WIDESPREAD INVESTOR HARM—AS ALLEGED IN THIS CASE.

The U.S. securities markets have grown enormously complex over the last several decades, resulting in a wide variety of venues to which orders to buy and sell securities may be routed for execution. Investors' orders can be sent to national and regional stock exchanges,[2] alternative trading systems such as dark pools and electronic communications networks,[3] and individual market makers. The "execution quality" of any particular order varies depending on where it is routed and ultimately where it is filled. Investors, particularly ordinary retail investors, do

[2] A list of national and regional stock exchanges is available on the SEC's website at https://www.sec.gov/fast-answers/divisionsmarketregmrexchangesshtml.html.

[3] A list of alternative trading systems is available on the SEC's website at https://www.sec.gov/foia/docs/atslist.htm.

not typically place orders directly on any particular venue; instead they rely on brokers such as TD Ameritrade to place orders on their behalf. And most investors rely on the expertise of their brokers (and the attendant duty to seek best execution) to determine how best to route an order, instead of issuing routing instructions to their broker. Accordingly, in most situations, the execution quality an investor will receive for a particular order is determined by their broker's routing decisions and the broker's exercise of the discretion entrusted to them by their clients. *United States v. Szur*, 289 F.3d 200, 211 (2d Cir. 2002) ("a general fiduciary duty, triggering a duty to disclose, arises when brokers have discretionary authority over their customers' accounts.") This dependence, inherent in all principal-agent relationships, explains the application of the fiduciary duty to trade execution decisions, requiring brokers always to seek best execution for client orders.

Meanwhile, trading venues want to attract liquidity and order flow. To do so, many of them provide lucrative financial incentives so that brokers will route orders their way. It is this conflict of interest—the incentive for brokers such as TD Ameritrade to route customer orders to exchanges that offer the best financial incentives to them rather than to those venues that offer the best execution for their investor clients—that is at the heart of this case.

A. <u>The Obligation to Seek Best Execution Arises Under the Fiduciary Duty As Well as Self-Regulatory Organization ("SRO") Rules.</u>

A broker's duty of best execution arises from the fiduciary duty inherent in the principal-agent relationship. *Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 135 F.3d 266, 270 (3d Cir. 1998). As one commentator has explained, adherence to this fiduciary standard is essential for the proper functioning of the securities markets:

> Because the client places such a tremendous amount of faith—and more importantly for the securities market, a tremendous amount of money—in the broker-dealer, she must be safeguarded by fiduciary principles. The existence of the fiduciary obligations to the client assures that her transactions will be conducted solely for her benefit, not the broker-dealer's. This protection extends not only to whether the transaction is executed, but also to when and how it is executed. Thus, fiduciary obligations protect the invaluable integrity of the market.

Brian J. Wanamaker, *Class Actions and Rule 10b-5: A Critique of Newton v. Merrill Lynch*, 80 WASH. U. L. Q. 997, 1020 (2002). As the Supreme Court has noted, the fiduciary duty is a duty of "utmost good faith and full and fair disclosure of all material facts." *Sec. & Exch. Comm'n v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963). And as the Eighth Circuit has recognized, fiduciary duties are "the highest known to law." *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585, 598 (8th Cir. 2009) (quoting *Donovan v. Bierwirth*, 680 F.2d 263, 272 n.8 (2d Cir. 1982)).

In the context of best execution, this fiduciary duty requires that for each and every non-directed order, a broker must make a reasonable effort to seek best execution on behalf of its client. *Id.* Brokers' adherence to their fiduciary duties, and the availability of meaningful remedies for violations of fiduciary duties, are especially important for ordinary retail investors, who entrust brokers with their hard-earned savings and lack the resources to monitor the complex and distant operations of large Wall Street brokerage firms such as TD Ameritrade.

The scope of the duty of best execution is also informed by rules of the Financial Industry Regulatory Authority ("FINRA"), an SRO. For example, FINRA Rule 5310(a)(1) requires that—

> In any transaction for or with a customer or a customer of another broker-dealer, a member and persons associated with a member shall use reasonable diligence to ascertain the best market for the subject security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions.

Rule 5310(a)(1) also highlights five factors that FINRA will consider when determining whether a broker used "reasonable diligence" to comply with the duty of best execution: "the character of the market for the security….the size and type of transaction...the number of markets checked…accessibility of the quotation; and…the terms and conditions of the order which result in the transaction." *Id.*

B. Payments for Order Flow Create Powerful Conflicts.

To attract order flow, many venues offer powerful financial incentives to brokers. The specific forms and terms of compensation vary. Some venues offer up-front payments to brokers who route orders to them, known as payment-for-order-flow. Other venues offer payments to brokers that route orders that place liquidity on the venue, i.e. non-marketable orders, but charge a fee to brokers that route orders that remove liquidity from the venue by matching an existing order; this is known as the maker-taker model.[4]

These financial incentives are inherently controversial, as they plainly present a conflict of interest for brokers who have a fiduciary duty to seek best execution and to route orders *solely* for the benefit of clients. And the conflict of interest is intense, as these financial order routing incentives are highly profitable for brokerage firms. For example, TD Ameritrade's own public filings show that from 2011 through 2018, the firm received nearly *$2.3 billion* in order routing revenue. *See* TD Ameritrade Holding Corp., Annual Report (Form 10-K), at 37 (Nov. 16, 2018), *available at*

[4] Some venues have a taker-maker model, in which they actually charge a fee for orders that place liquidity on the venue and pay a rebate for orders that remove liquidity from the venue.

https://www.sec.gov/Archives/edgar/data/1173431/000117343118000125/amtd_20180930x10k.htm; TD Ameritrade Holding Corp., Annual Report (Form 10-K), at 34 (Nov. 20, 2015), *available at* https://www.sec.gov/Archives/edgar/data/1173431/000117343115000169/amtd_20150930x10k.htm; Press Release, TD Ameritrade, TD Ameritrade Discloses Order Routing Revenue Sharing (June 12, 2014), *available at* https://www.sec.gov/Archives/edgar/data/1173431/000117343114000042/revenue_sharexexhibitx991.htm.

While the SEC has not yet determined that accepting financial incentives for order routing is a *per se* violation of the duty of best execution, Payment for Order Flow, Exchange Act Release No. 34,902 (Oct. 27, 1994), 59 Fed. Reg. 55,006, 55,008-10 (Nov. 2, 1994), it has nevertheless made clear that the duty to seek best execution must always supersede any other considerations, including any payments the broker may receive. *Id.* This is, of course, a logical outgrowth of the broker's fiduciary duty to assure that transactions are conducted "*solely* for [the client's] benefit" rather than the broker's. Wanamaker, *supra*, at 1020 (2002).

Accordingly, a broker with a policy or practice of routing orders solely or predominantly to maximize order routing revenue, rather than seeking best execution for its clients, violates the duty of best execution with respect to each and every customer order routed according to that policy or practice. *Id.* ("Because the plaintiffs claimed a breach of the duty of best execution with respect to each client, the evidence of injury should have come from common proof that the defendants uniformly failed to fulfill the duty of best execution based on the system they used.").

C. <u>The Harm to Investors and the Markets Is Collectively Huge.</u>

Whether or not an investor's order receives best execution is not a trivial matter, particularly for ordinary retail investors with relatively limited resources. Anything less than best execution means a loss of real money for these investors—fewer savings available to meet basic needs, to fund a college education, to plan for retirement, or to achieve other life goals.

Investors suffer the most obvious and direct harm from violations of the duty to seek best execution when a broker routes an order to a venue with a price for the security that is worse than the price available on another venue. This is an especially prevalent concern for "marketable" orders, i.e. orders for a security at a price that can be executed at the current publicly quoted price.[5] That publicly quoted price

[5] A marketable order can either be an order to buy (or sell) a security at a specific price that is higher (or lower) than the currently prevailing best offer (or bid), or simply an order to buy or sell at whatever is the current prevailing price. In either case, the investor would benefit if the broker routed the order to the venue offering the most favorable price for its client.

may not actually be the best available price, due to a number of factors such as delays between the time a particular trade occurs and the time that trade is incorporated into public pricing data. Routing marketable orders to the venue that offers brokers the highest payment for the order does nothing to ensure that clients will receive the most favorable price for the security. And, indeed, it has been demonstrated that this practice is costly for investors, with one study estimating that the annual drain on investor funds resulting from brokers routing marketable orders to the venues that pay the most for those orders is $5 *billion*. Katya Malinova & Andreas Park, *Subsidizing Liquidity: The Impact of Make/Take Fees on Market Quality*, 70 J. FIN. 509, 535 (2015) (citing industry study).

For non-marketable orders, i.e. orders that cannot be filled at the prevailing public market price,[6] other execution quality factors come into play. A broker seeking best execution for a non-marketable order should make reasonable efforts to seek a venue that would maximize the likelihood of the order getting filled at the best price *and* as quickly as possible. Routing non-marketable orders to venues that pay brokers the most for those orders not only violates the duty to *seek* best

[6] For example, if a security is trading at $10 a share, an order to buy 100 shares at $9 would be non-marketable.

execution, but also increases the likelihood of worse execution in fact, causing real harm to investors.

For example, a broker seeking to maximize revenue from routing orders would send a non-marketable order to a maker-taker venue that offers the highest rebate for adding liquidity. However, that venue is also likely to have a high "take" fee for orders that remove liquidity (maker-taker venues charge higher "take" fees than they pay in "make" rebates and pocket the difference). Consequently, other brokers will be less likely to route orders that might remove liquidity, i.e. that might execute against the client's resting order, to that venue. The end result is that the order is less likely to be filled, or will be filled more slowly, all to the detriment of the client. This is not mere speculation: Academic studies have confirmed that non-marketable orders routed by brokers seeking to maximize revenue are less likely to be filled, and when they are filled, are filled more slowly. Robert Battalio, Shane A. Corwin & Robert Jennings, *Can Brokers Have it All? On the Relation between Make-Take Fees and Limit Order Execution Quality*, 71 J. FIN. 2193, 2222 (2016).[7]

Compounding the problem, the opaque if not invisible nature of these financial injuries makes it difficult for ordinary individual investors (and even for

[7] The Battalio analysis reveals yet another layer of harm: Client orders are less likely to be filled when there is an *advantageous* price movement for the client, and more likely to be filled when there is an *adverse* price movement. Battalio, *supra*, at 2194.

the SEC and FINRA) to police violations. Ordinary investors generally do not have insight into their brokers' real-time order flow mechanics, and it is not generally feasible or cost effective for an investor to attempt to evaluate order execution quality to detect the harm that arises from brokers who route orders to maximize payments for themselves rather than seeking best execution. *See* Allen Ferrell, *A Proposal for Solving the "Payment for Order Flow" Problem*, 74 S. CAL. L. REV. 1027, 1048 (2001) ("It may very well be prohibitively expensive for many small investors to acquire the necessary expertise and information to make a meaningful judgment about whether a broker has sent their orders to the appropriate market.").

II. A CLASS ACTION IS AN INDISPENSABLE METHOD OF ADJUDICATING THIS CASE, AS IT ALONE CAN ACHIEVE THE REMEDIAL AND DETERRENT PURPOSES UNDERYLYING THE SECURITIES LAWS.

The class action mechanism is not only the superior method of adjudicating the type of allegations in this case, *see* Fed. R. Civ. P. 23(b)(3), it is actually the only mechanism capable of effectively alerting investors to their status as victims, providing compensation for their injuries, forcing disgorgement of ill-gotten gains from lawbreakers, deterring systemic abuses more broadly, and ultimately maintaining confidence in the integrity of our capital markets.

A. **The Incremental and Obscure Nature of the Harm that Payment for Order Flow Causes Investors Requires the Availability of a Viable Class Action Remedy.**

Violations of the duty of best execution result in harm that is on the order of cents per share traded, dollars per order, thousands of dollars per customer, and millions to tens-of-millions of dollars aggregated across a broker's customer base. Thus, violations of the duty of best execution represent precisely the type of case for which class actions are intended, involving widespread harm that is large in the aggregate yet too small to justify the enormous cost of litigation on an individual basis, requiring extensive expert analysis, grueling discovery, and intense motions practice.

Moreover, these individual harms are difficult to detect. The average retail investor is likely unaware that payments for order flow exist, that they compromise brokers' order routing decisions, and that they cost the investor real money. Further, investors are unlikely to know what alternatives they have and how they might find brokerage services untainted by the payment for order flow practice. Under these circumstances, most everyday investors are likely to discover this form of trading abuse only after receiving notice of a class action lawsuit. In short, without the class action to alert investors to abusive practices and to provide an avenue of redress, ordinary investors will continue to suffer death by a thousand cuts with no meaningful remedy. And the lesson for brokers and other market participants is clear: They can profit from violating their fiduciary obligations with little, if any, fear of being caught or held accountable.

B. <u>Contrary to the Claims of Defendants' Amicus, Government Enforcement Is No Substitute for a Meaningful Private Remedy.</u>

The Securities Industry and Financial Markets Association ("SIFMA"), in its amicus brief in support of the Defendants, actually demonstrates the necessity (and superiority) of a class action to resolve this and similar allegations of abuse. SIFMA argues that the duty of best execution is actively enforced by the SEC and FINRA, suggesting that investors do not need the availability of class actions as protection against broker violations of the duty of best execution. SIFMA Brief at 10. But those enforcement actions resulted in virtually no recovery for victims; moreover, the fines imposed represented only a fraction of the huge potential revenues available to brokers who violate their duty to seek best execution, rendering these actions ineffective as deterrents.

Of the five best-execution enforcement actions SIFMA cites, four apparently did not involve the return of *any* restitution to injured customers. *See Geman v. SEC*, 334 F.3d 1183, 1185 (10th Cir. 2003) (noting that the SEC fined a broker, without discussion of restitution); *In re Scottrade, Inc.*, Exchange Act Release No. 58012, 2008 WL 2510611, at *6 (June 24, 2008) (imposing civil money penalty on broker, without discussion of restitution); *In re Credit Suisse Sec. (USA) LLC*, Exchange Act Release No. 10565, 2018 WL 4678498, at *9 (Sept. 28, 2018) (imposing civil money penalty on broker, without discussion of restitution); *In re StockCross Financial Services, Inc.*, FINRA Case No. 2016048243101 at 2-3 (Sept. 7, 2018) (imposing fine, without discussion of restitution).[8] Only one enforcement action cited by SIFMA resulted in the payment of restitution, a grand *total* of $16,258.08, representing a substantial loss to an investor but an amount still far short of the loss necessary to justify litigation or even arbitration. *See In re Selkirk Investments, Inc.*, FINRA Case No. 2015045624401 (Mar. 6, 2018).

The cases cited by SIFMA also demonstrate that SEC and FINRA enforcement alone will not meaningfully deter wrongdoing. In those five enforcement actions, the perpetrators paid an average fine of just over $2.2 million, with the largest single fine being an outlier of $10 million. In contrast, and by its own admission, TD Ameritrade made many times that amount from payments it received for routing orders. In one single year, for example, TD Ameritrade alone received revenue from order routing of $458 million, *see* TD Ameritrade Holding Corp., Annual Report (Form 10-K), at 37 (Nov. 16, 2018), *available at*

[8] SIFMA appears to erroneously indicate this case involved restitution.

https://www.sec.gov/Archives/edgar/data/1173431/000117343118000125/amtd_20180930x10k.htm, over *45 times* the single largest fine of any of the enforcement actions cited by SIFMA, and over *200 times* the average fine levied in those cases. Thus, SIFMA's brief actually makes clear that SEC and FINRA enforcement actions do not compensate victims of broker violations of the duty of best execution, nor do they serve as an effective deterrent.

A private right of action "constitutes an essential tool for enforcement of the" duty of best execution. *See Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988). And for that private right of action to be a meaningful, it must be in the form of a class action. If certification is denied here, the protections of the duty of best execution will, for all intents and purposes, be an illusory one for investors, who will be preyed upon by brokers seeking to gain at their expense.

III. THE COURT SHOULD AFFIRM THE DISTRICT COURT'S CERTIFICATION OF THE CLASS AND REJECT THE DEFENDANTS' ATTEMPTS TO DISCREDIT THE APPELLEE'S ALOGRITHM FOR ASSESSING EONOMIC HARM AND TO EVADE THE PRESUMPTION OF RELIANCE.

Among the pre-requisites for maintaining a class action, in addition to those set forth in Fed. R. Civ. P. 23(a),[9] is a finding by the court that "questions of law or

[9] The Rule 23(a) requirements are: numerosity, commonality, typicality, and adequacy.

fact common to class members predominate over any questions affecting only individual members." Fed. R. Civ. P. 23(b)(3). The district court correctly made this finding, and in so doing, concluded that the Plaintiff could "show on a classwide basis that the class members suffered some economic loss caused by a failure by TD Ameritrade to provide best execution." *Klein v. TD Ameritrade Holding Corp.*, 327 F.R.D. 283, 297 (D. Neb. 2018). It further recognized the propriety of applying the presumption of reliance across the class in accordance with *Affiliated Ute.* Both of these decisions were well within the sound discretion of the district court, aligned with the better-reasoned and most recent authority, and entitled to affirmance.

A. <u>Classwide Issues Predominate.</u>

It bears emphasis in this case that Plaintiff is alleging not only that TD Ameritrade committed individual violations of its duty to seek best execution, but also that TD Ameritrade *systematically* flouted that obligation, in pursuit of hundreds of millions of dollars in order flow payments. This demonstrates the degree to which common questions of fact and law predominate over questions affecting individual members of the class. Uniform routing of orders without seeking best execution, as Plaintiff alleges, is always a violation of the duty of best execution. Thus, to be determined at the merits stage in this case is whether TD Ameritrade had a practice of prioritizing financial incentives from venues over best execution for clients, and whether such a practice violated the duty to seek best execution. Each of these issues can clearly be resolved on a classwide basis.[10]

B. <u>Because the Calculation of Damages Will Not Require Individual Mini-trials, the Issues Surrounding TD Ameritrade's Violation of the Duty of Best Execution and Reliance Predominate.</u>

While damages ultimately will have to be determined on an individualized basis at the merits stage, the Eighth Circuit, following the Supreme Court's lead, has been clear that the "potential need for individualized damages inquiries is not sufficient to overcome the district court's findings of predominance and superiority." *Stuart v. State Farm Fire & Cas. Co.*, 910 F.3d 371, 376 (8th Cir. 2018) (citing *Tyson Foods, Inc. v. Bouaphakeo,* 136 S. Ct. 1036 (2016)). Rather, the clear concern of the Rule 23(b)(3) inquiry is the efficiency and/or difficulty of adjudicating the matter as a class action. For example, where determining individualized damages would require individual mini-trials for each member of a large class, a class action may not be an appropriate vehicle for resolving the

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[10] The broker's duty is to *seek* best execution for every order, but not necessarily to *achieve* best execution for every order. Wanamaker, *supra,* at 1020 ("The broker-dealer should be judged with regard to her process of execution rather than the outcome of it, i.e., did the broker-dealer use 'reasonable efforts' to obtain the best execution?"). If a broker routes an order solely to maximize payment for that order, without seeking best execution, it has nevertheless violated its duty of best execution. *Newton,* 135 F.3d at 270.

litigation. However, the district court determined that the Plaintiff's expert had developed an algorithm that could reliably and efficiently determine damages for each member of the class. Accordingly, because those damages can and will be determined on a classwide basis, individualized mini-trials to ascertain damages will not be required, and certification is proper under Rule 23.[11]

The court's ruling is in accordance with the most recent authority to consider the issue. In *In re NYSE Specialists Sec. Litig.*, 260 F.R.D. 55 (S.D.N.Y. 2009), the Southern District of New York confronted the question of whether class issues predominate where the plaintiffs had proposed an algorithm that could calculate damages across the class. In a thoughtful opinion, that court rejected the defendant's argument that individualized inquiries into the existence and extent of class members' damages precluded a finding of predominance. Instead, the court correctly reasoned that because the plaintiff was not seeking a presumption of

[11] Defendants contend that the Plaintiff's algorithm is incapable of doing what it promises. First, as Plaintiff and the district court aptly noted, the proposed algorithm is not novel, but is widely used precisely as it would be here—to determine whether a particular order received best execution. *Klein*, 327 F.R.D. at 295. Second, as the record makes clear, to the extent the algorithm has shortcomings, they are due to the Defendants' failure to provide the necessary discovery and they can be remedied at a later stage. It would be premature to deny class certification based on Defendants' speculation about the functionality of the algorithm and especially inappropriate given that any functionality deficiency at this stage is due to Defendants' conduct. In any event, as necessary and appropriate, the court's order granting class certification can be altered or amended. *See* Fed. R. Civ. P. 23(c)(1)(C).

damages, but instead "had established that it can prove economic loss through the application of its algorithm to the NYSE trading data for the Class Period," common issues predominated. *Id.* at 80. This well-reasoned principle applies here as well: Where the sole individual issues are the existence and extent of damages, and where those issues can be resolved through application of an automated, mechanical process, common issues predominate.

Nor do individual investors' subjective mindsets need to be considered to evaluate "best execution." Defendants and their amici assert that the class should not have been certified because to determine whether a particular order actually received best execution (notwithstanding TD Ameritrade's violation of its duty to *seek* best execution), each investors' subjective state of mind purportedly must be examined to determine the investor's trading strategy. Def's Br. At 46-48. This argument is a red herring. No investor would wish to buy (or sell) a security at a higher (or lower) price than they have to. Nor would they prefer that their orders suffer delays in execution or languish indefinitely without ever being filled. As the Fifth Circuit has noted, an element of the duty of best execution is to "use reasonable efforts to execute the order promptly." *Magnum Corp. v. Lehman Bros. Kuhn Loeb*, 794 F.2d 198, 200 (5th Cir. 1986).

In short, while there are a number of factors that determine whether a particular order received best execution (including price, the likelihood of being filled, and the time necessary to fill), these factors are all objective. One need not examine the subjective state of mind of an investor to know that they want the best outcome in terms of these variables.

C. <u>**Reliance Can Be Presumed on a Classwide Basis.**</u>

In the seminal case of *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972), the Supreme Court held that in a securities fraud case "involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery," but instead the "*obligation to disclose* and this withholding of a material fact establish the requisite element of causation." *Id.* at 153 (emphasis added). Although Plaintiff also alleges some affirmative misstatements by TD Ameritrade, the "obligation to disclose" that arises from the independent fiduciary duty TD Ameritrade owed to the Plaintiff, and its failure to meet that obligation, make this case "primarily a failure to disclose," squarely within the well-established *Affiliated Ute* rule allowing reliance to be presumed.

Courts applying the *Affiliated Ute* presumption of reliance have sometimes struggled to determine when a case involves "primarily a failure to disclose" as opposed to primarily affirmative misrepresentations. The difficulty arises because in some cases it is easy to turn an affirmative misrepresentation into an omission simply by framing the omission as the failure to state the truthful proposition that would correct the misrepresentation. In such cases courts are reluctant to apply the presumption to an omission that is "simply the inverse of the Plaintiff's misrepresentation allegation" or to "misstatements whose only omission is the truth that the statement misrepresents." *Waggoner v. Barclays PLC*, 875 F.3d 79, 96 (2d Cir. 2017). The concern is that by treating such cases as primarily about omissions, the distinction between affirmative misstatements on the one hand and omissions on the other hand would collapse, meaning the *Affiliated Ute* presumption of reliance would apply to every case where there is a misrepresentation.

However, the Court need not wrestle with such difficulties here. Because brokers executing client orders are acting as fiduciaries, they have an affirmative duty to make "full and fair disclosure of all material facts." *Capital Gains Research Bureau, Inc.*, 375 U.S. at 194 (1963). Thus, TD Ameritrade had an obligation to disclose its policy or practice of maximizing revenues for itself in routing client orders, rather than seeking best execution for its clients. This obligation to disclose, grounded in the fiduciary duty, renders this case primarily one of a failure to disclose, regardless of the degree to which the Defendants also made affirmative misrepresentations to class members.[12]

Cases involving more typical allegations under Rule 10b-5 illustrate the distinction. In *Wilson v. Comtech Telecommunications Corp.*, 648 F.2d 88 (2d Cir. 1981), the president of the defendant company made various good-faith predictions about the company's profits and sales in the coming year. When the president later became aware that those statements were no longer accurate, he failed to disclose the new information. *Id.* at 91-92. The plaintiff purchased stock in the company just before the new information was released, and when the information was released, the price of the stock dropped and the plaintiff lost money. *Id.* at 92. Lacking credible evidence that he relied on the earlier statements in purchasing the company's stock, the plaintiff asserted that the case was primarily about the president's later omission of new information, and so argued that the *Affiliated Ute* presumption of reliance applied. *Id.* The Second Circuit disagreed, holding that regardless of the later "omissions," since those omissions related back to the earlier statements (which though true at the time, became affirmative misstatements when

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[12] Plaintiff correctly points out that *Affiliated Ute* also involved affirmative misrepresentations, so any argument that the presumption only applies for "pure omission" cases is without merit. Appellee Br. at 57-59.

the president learned the new information), the plaintiff still had to prove reliance on the earlier misstatements. *Id.*

Unlike this case, the defendant in *Wilson* had no independent duty to reveal what he knew about the company's performance prior to the release of the quarterly reports. The omission on which plaintiff Wilson sought to rely for purposes of the *Affiliated Ute* presumption was entirely dependent on the existence of a prior affirmative statement. By contrast here, TD Ameritrade was under a fiduciary obligation to make full and fair disclosure *of all material facts*, entirely apart from the duty to correct any prior misrepresentations it may have made. Even if TD Ameritrade chose not to make affirmative claims that it always sought best execution, it was nevertheless required to inform clients that its sole or primary consideration for order routing was maximizing its own revenue, and that this could result in inferior order execution quality. Its failure to make those disclosures classifies this case as one primarily involving omissions, warranting application of the *Affiliated Ute* presumption.

A more restrictive reading of *Affiliated Ute* leads to an absurd result: If reliance cannot be presumed where brokers have breached their fiduciary duty to disclose all material facts, simply because the broker has also engaged in some misrepresentations touching on the omitted information, then brokers can immunize themselves from *class certification* through the artful use of falsehoods. Indeed, unless the district court's ruling is affirmed on this issue, such an indefensible result will come to pass in this case.

CONCLUSION

For all of the foregoing reasons, and those set forth in the Plaintiff's brief, this Court should affirm the district court's class certification order.

Respectfully submitted,

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I hereby certify that on May 8, 2019, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Eighth Circuit by using the CM/ECF system. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the CM/ECF system.

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Dated: May 8, 2019