IN THE COURT OF APPEALS
THIRD APPELLATE DISTRICT

MAY 20 2004

DALE BURNS, GARY HALPIN, KAY HUTCHINS, on behalf of themselves and all others similarly situated,	
Plaintiffs-Appellees,	**Case No. 03 AP 0049**
v.	**Regular Calendar**
PRUDENTIAL SECURITIES, INC. and JEFFREY PICKETT,	**Appeal from the Marion County Court of Common Pleas**
Defendants-Appellants.	

BRIEF OF DEFENDANT-APPELLANT PRUDENTIAL SECURITIES, INC.

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Assignment of Error No. 1

The Trial Court Erred By Failing To Hold That As A Matter Of Law Plaintiffs Ratified The Unauthorized Trades. (*See* Ruling on Defendants' Motions for Summary Judgment (7/19/02); Judgment Entry (7/24/03).)

Issues:

- Plaintiffs' failure to object to the unauthorized trades upon learning of them constitutes ratification.
- Once defendants disclosed the unauthorized trades to plaintiffs, defendants satisfied the limited duties owed to plaintiffs, who had non-discretionary investment accounts.
- Defendants did not owe plaintiffs a "continuing" or "ongoing" duty.

Assignment of Error No. 2

The Trial Court Erred In Its Jury Instructions On Ratification And Fiduciary Duty. (*See* Tr. 10/9/02, Jury Inst. at 2105, 2111.)

Issue:

- The trial court's jury instructions were inconsistent with the standards for brokers handling non-discretionary accounts.

Assignment of Error No. 3

The Trial Court's And Jury's Erroneous Application Of The New York Rule Of Conversion Damages To Plaintiffs' Contract Claim Requires A New Trial Or Judgment In Favor Of Defendants. (*See* Tr. 10/9/02, Jury Instr. at 2109; Tr. 10/1/02, Court at 178; Jury Interrog. at 2 (10/11/02).)

Issues:

- New York courts do not apply the New York Rule of conversion damages to contract claims.
- Even if the New York Rule does apply, the jury erred in calculating the reasonable period for judging plaintiffs' damages.

Assignment of Error No. 4

The Trial Court Erred By Failing To Dismiss Plaintiffs' Punitive Damages Claims As A Matter Of Law. (*See* Tr. 10/3/02, Court at 1792; Judgment Entry (7/24/03).)

Issues:

- Because the unauthorized trades were made without malice, they cannot serve as the basis for a punitive damages award.
- Because defendants did not owe a continuing or ongoing duty to these non-discretionary account customers, this alleged duty cannot serve as the basis for a punitive damages award.
- There is no other basis to support a punitive damages award.

Assignment of Error No. 5

The Trial Court And Jury Erred By Finding Malice On The Part of Prudential Securities, Inc. ("PSI"). (*See* Jury Interrog. at 4, 10; Judgment Entry (7/24/03).)

Issues:

- To the extent there was a legal basis for plaintiffs' punitive damages claim, defendants' conduct was not malicious.
- Plaintiffs' evidence did not satisfy Ohio's clear and convincing standard for proving malice.

Assignment of Error No. 6

The $250 Million Punitive Award Violates PSI's Due Process Rights And Requires A New Trial Or Drastic Remittitur. *State Farm Auto Ins. v. Campbell*, 538 U.S. 408 (2003). (*See* Judgment Entry (7/24/03).)

Issues:

- The over 40:1 ratio between tort compensatory and punitive damages is plainly unconstitutional.
- PSI's conduct falls far short of the kind of reprehensibility that supports a punitive damages award.
- The punitive award bears no relation to the civil penalties that could be imposed for comparable conduct.

Assignment of Error No. 7

The Punitive Award Violates The Ohio Constitution And Requires A New Trial Or Drastic Remittitur. (*See* Judgment Entry (7/24/03).)

Issues:

- The punitive award violates the Ohio Constitution's "due course of law" requirement.
- The Ohio Constitution provides additional protections over and above those in the United States Constitution.

Assignment of Error No. 8

The Punitive Award Violates Ohio's Limits On Punitive Damages And Requires A New Trial Or Drastic Remittitur. (*See* Judgment Entry (7/24/03).)

Issues:

- The jury's excessive punitive damages award was infected by passion and prejudice.
- The jury's award is unsupported by the evidence.
- The award is dramatically out-of-line with past punitive awards in Ohio, most notably those in economic damages cases.
- Plaintiffs' counsel's misconduct tainted the verdict.
- Plaintiffs relied on inflated and legally improper financial figures in seeking a punitive damages award.

Assignment of Error No. 9

The Trial Court Erred By Denying Defendants' Motion To Change Venue. (*See* Ruling on Defendants' Motion to Change Venue (9/12/02); Tr. 9/12/02, Court at 301; Judgment Entry (7/24/03).)

Issue:

- The prejudicial pretrial publicity–fueled by plaintiffs' counsel's prejudicial statements–coupled with the local ties of the plaintiff class and the jury makeup require a new trial in a new venue.

Assignment of Error No. 10

The Trial Court's Errors And Plaintiffs' Misconduct Before And During Trial Require A New Trial. (*See* Tr. 9/12/02, Court at 212, 268; Tr. Tr. 9/18/02, Court at 541; Judgment Entry (7/24/03).)

Issues:

- The trial court, with plaintiffs' counsel's support, allowed two relatives of class members to sit on the jury.
- Plaintiffs' counsel, after initially opposing the idea of reading the names of the class members to the jury pool to clear up any potential conflicts, improperly disclosed the names of over 50 class members to the jury in the middle of trial.
- Plaintiffs' counsel unfairly capitalized on the local publicity and jury makeup by stressing their clients' local ties and relationship to the jurors.
- Plaintiffs' counsel improperly accused PSI of criminal conduct and, in addition, asked the jury to hold PSI responsible for the wrongdoing of other companies, in violation of the trial court's in limine ruling.

Assignment of Error No. 11

The Trial Court Erred By Failing To Decertify The Class. (*See* Judgment Entry (7/24/03).)

Issues:

- Plaintiffs' post-certification switch in legal theories made the case unsuitable for class treatment.
- Plaintiffs' trial case focused on its "continuing duty" theory, which is not susceptible to class proof as it requires an individual inquiry into what each plaintiff knew about their asserted rights and the market as well as other individualized issues.
- Defendants' ratification defense is not susceptible to class proof.
- Compensatory and punitive damages could not be awarded in the absence of individualized determinations of harm.

Assignment of Error No. 12

The Trial Court Did Not Have Jurisdiction Over This Class Action, Which Is Based Upon Alleged Misrepresentations And Omissions Made In Connection With The Purchase Or Sale Of A Covered Security. (*See* Journal Entry (9/6/02).)

Issues:

- The Securities Litigation Uniform Standards Act, or SLUSA, precludes state law class actions that, like this one, allege a "misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security."
- Because plaintiffs' primary claims at trial centered upon whether defendants omitted or misrepresented certain facts to plaintiffs, the case is preempted by federal law.

INTRODUCTION

Justice was denied in this case. The jury awarded (and the trial court upheld) a staggering $261 million in damages against Prudential Securities, Inc., the sole corporate defendant in this case ("PSI"), $250 million of which were punitive damages. The sheer magnitude of this judgment, unprecedented in Ohio, demonstrates its invalidity.

The case arises from unauthorized trades made by former PSI broker Jeffrey Pickett in the non-discretionary investment accounts of approximately 250 clients in October 1998. As all concede, the trades were not motivated by malice or thought of pecuniary gain by Mr. Pickett. Rather, they were made due to his concern for his retirement-age clients in Marion, many of whom had their assets invested in equity mutual funds, putting them at risk of losing their retirement savings in the event of a market crash. With this in mind, Mr. Pickett, believing a crash was imminent, reallocated his clients' assets to more conservative money market holdings.

Mr. Pickett's clients were immediately notified of the trades, and many later attended a seminar Mr. Pickett hosted for the express purpose of explaining the trades and his views on the market. Upon learning all of this, no plaintiff objected to the trades or asked that they be placed back in the market. Hearing no objections, PSI believed the matter had come to an end.

Months later, as the market enjoyed a final surge before the historic collapse of 2000, all of this changed. Mr. Pickett's clients became frustrated that they were not fully participating in the market run up, and some chose to reenter the market. Given the ensuing crash, however, had plaintiffs, who admittedly were buy-and-hold investors, stood by Mr. Pickett's reallocations, they would have been far better off by the time of trial.

What began with a concerned broker's good intentions culminated in a trial that went awry in nearly all respects. The jury, drawn from the same small community where the class members lived and where adverse pretrial publicity engulfed the case, included at least two relatives of the plaintiff class, a *per se* violation of the right to a fair trial. Remarkably, the trial court refused to let PSI inquire whether other jurors also had relatives or friends in the class.

Plaintiffs' counsel, who made every effort to taint the jury pool before trial, seized upon these conflicts during it, imploring the jury to "help the good people of Marion." Counsel then violated a court order by making frequent references to Enron-like corporate misconduct and making other allegations (*e.g.*, accusing PSI of criminal conduct) outside the bounds of fair play.

Regarding liability, the trial court failed to recognize that plaintiffs ratified the trades. It also permitted the jury to award damages on a theory that is inapplicable to contract claims. As to the tort claims, the court erred in holding that brokers for nondiscretionary accounts have fiduciary duties in advising their clients about investments, allowing the jury to impute to PSI far-reaching, continuing duties arising after the trades were made. More stunning was its decision to allow the jury to consider a punitive damage claim, one founded on a flawed legal theory, when there was no clear and convincing evidence of malice.

Most striking was the trial court's refusal to award a new trial for, or to drastically reduce, the $250 million punitive award for this economic injury. The highest punitive award sustained on appeal in Ohio history is $30 million, and that was for bad acts against a terminally ill and desperate patient. Here, there was no evidence that any defendant intended to harm the clients or acted with reckless disregard of a high probability of harm. Indeed, in a volatile market at no point is there a high probability that any investor will suffer financial loss by being moved into lower-risk investments.

Even if the threshold test of malice could be met, PSI's conduct falls no higher than the bottom rung of the reprehensibility ladder. In *State Farm Auto Ins. v. Campbell*, 538 U.S. 408

(2003), the Supreme Court made clear that awards above a 1:1 ratio of punitive to compensatory damages are unconstitutional if, like here, the compensatory damages are substantial and the asserted harm is economic. Given the deterrent effect of a large compensatory award, no rational purpose is served by a punitive award, much less one that is over 40 times the tort damages.

Exacerbating these problems, this case should never have been permitted to be tried as a class action. This Court previously affirmed certification on the ground that "the dominant issue is whether [PSI] is liable for selling the securities of its clients without prior authorization." *Burns v. Prudential Sec.,* 145 Ohio App. 3d 424, 430 (3d Dist. 2001). But this issue was not before the jury because the trial court granted plaintiffs summary judgment on it. Instead, plaintiffs switched their legal theories and premised their trial claims, in particular their punitive damages claim, on PSI's alleged failure to *reverse* Mr. Pickett's unauthorized trades and inform them of their options for reentry into a rising market. But the determinative facts for these theories, including each class member's knowledge of the trades and their actions in response, are individualized and thus are not appropriate for class treatment.[1]

STATEMENT OF THE CASE

Fearing a stock market crash, broker Jeffrey Pickett reallocated the investments of his retiree clients by moving their assets from equity mutual funds to more conservative money market funds. Because his clients were operating under "non-discretionary" account agreements, where the broker does not have discretion to make unapproved transactions, and because Pickett acted without their authority, his unilateral action violated the terms of the account agreements.

These trades served as the basis for this class action filed against Mr. Pickett and his

[1] The fact that plaintiffs' case at trial centered upon what defendants did (and did not) tell the class makes plain that this case involves allegations of "misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security," which are governed by the federal Securities Litigation Uniform Standards Act. 15 U.S.C. § 78bb(f)(1)(A). Accordingly, the class claims are preempted. *See infra* at 44-45.

employer, PSI. The putative class asserted that Pickett's conduct constituted a breach of contract and a breach of fiduciary duty, and that PSI was vicariously liable for this conduct as well as for its negligent supervision. After the class was certified and the trial court granted partial summary judgment to plaintiffs on their claims for unauthorized trading, the case moved ahead to trial. There, the case focused on the parties' conduct *after* the trades. Plaintiffs argued that PSI breached its "special" and "ongoing" duties by failing to give the class ongoing market advice and to tell them that the company would reverse the trades at its expense. Plaintiffs alleged that this "cover up" of Pickett's actions was malicious, entitling them to punitive damages. Defendants maintained that plaintiffs had ratified the trades, and denied a cover up.

The jury awarded plaintiffs over $11 million on their contract claim and nearly $6 million on their tort claims. The jury also found that PSI acted maliciously toward plaintiffs, awarding them $250 million in punitive damages. The trial court denied all of the post-trial relief requested by defendants, including its request to vacate or reduce the punitive damages award.

STATEMENT OF THE FACTS

A. The Markets' Decline And The Ensuing Reallocations.

In the fall of 1998, Mr. Pickett, a broker in PSI's Worthington, Ohio office, grew increasingly concerned about the stock market. It had dropped 20%, and economic indicators continued to slide. Tr. 9/19/02, Pickett at 862-65. Pickett worried most about his approximately 250 retirees, who were experiencing losses in their retirement mutual fund accounts. Tr. 9/13/02, Stip. Facts at 3; Tr. 9/18/02, Pickett at 635-36. The clients were heavily invested in equity funds, meaning that a sizeable drop in the market would be "devastating" to their irreplaceable retirement savings. Tr. 9/19/02, Pickett at 857-58. Based on his concerns, on October 7th and 8th, Mr. Pickett reallocated these clients' accounts without their permission, moving their assets from a mutual fund program made up largely of equity investments to one consisting primarily of government money market investments. Tr. 9/18/02, Pickett at 611. "Neither Prudential nor Pickett charged a commission on the reallocations, nor did Prudential or Mr. Pickett earn any other compensation based on the reallocations." Tr. 9/13/02, Stip. Facts at 6.

Despite his high-minded intentions, Mr. Pickett's actions clearly violated the terms of his relationship with his clients. These clients had non-discretionary accounts with PSI, *id.* at 3, meaning that the clients, not Mr. Pickett, controlled the accounts. *See id.* at 5. Thus, no action could be taken in the accounts absent client approval.

Within days, Mr. Pickett's clients received confirmation slips from PSI informing them of the unauthorized trades. Tr. 9/13/02, Stip. Facts at 6. In addition, in early November, PSI sent each client a second mailing, this time a monthly statement listing the reallocations. *Id.* at 7. Mr. Pickett and his staff also made efforts to reach the clients, calling many of them to explain the transactions and why Pickett believed a market crash was imminent. Mr. Pickett met with other clients in person. *Id.* at 6-7; Tr. 9/13/02, Pickett at 585. And on November 12, "[m]ost of the class members" attended a seminar where Mr. Pickett discussed the reallocations and why he felt the market was too risky for the clients at that time. Tr. 9/13/02, Stip. Facts at 7; Tr. 9/19/02, Pickett at 827. There, the clients "were given the opportunity to ask questions regarding the reallocations and Mr. Pickett's reasons" for making them. Tr. 9/13/02, Stip. Facts at 7. No class member asked to reverse the trades. *See id.* at 8; Tr. 9/18/02, Pickett at 689. In fact, many of them thanked Pickett for looking out for their interests. *Id.* at 611; Tr. 9/19/02, Pickett at 714.

PSI's managers became aware of Pickett's trades shortly after they were made. Tr. 10/1/02, Roy at 27-28. Given the volume of the reallocations, PSI thought it unlikely that Pickett had obtained authorization for all the trades. PSI also recognized, however, that prior to the reallocations, many of the retiree clients may have been too heavily invested in equities, such that the reallocations would have been in their best interest. *Accord* Tr. 9/18/02, Cortez Dep. at 49, 66-68. PSI further realized that Mr. Pickett made the trades with his clients' interests in mind and that he did not earn a commission from them. *See* Tr. 10/3/02, Roy at 1862. After a "thorough investigation," *id.* 1837, hearing no complaints, and believing that the "customers had decided to keep the more conservative positions that Jeff had put them in," *id.* at 1860-62, PSI felt the matter had come to a close. *See id.* at 1861-63; Tr. 9/23/02, Farley at 1138, 1180, 1196.

B. A Temporary Rebound, Then The Crash.

Although its historic crash in 2000 ultimately proved Mr. Pickett right, in late 1998 and 1999 the stock market enjoyed a temporary rebound, reaching new highs. Having been spared the equity market's volatility, the retirees also continued to earn a return on their investments. *See, e.g.*, Tr. 9/16/02, Van Meter at 240, 245; Tr. 9/17/02, K. Vincent at 446.

Ultimately, Mr. Pickett was terminated by PSI. Tr. 9/13/02, Stip. Facts at 8. In his place, other PSI brokers, many of whom had a rosier view of the market's future, began to work with his former clients. *Id.* This, coupled with the market's rapid rise from its low in October 1998, led some clients to decide to reenter the market in the spring of 1999. Tr. 9/24/02, Burns at 1356. Around this same time, PSI began to receive its first complaints from Mr. Pickett's former clients, with one e-mail arriving in December 1998, *see* Pl. Ex. 34. No other complaints were voiced until March 1999, five months after the trades. *See* Tr. 9/26/02, Dixon at 1560-62.

In early 2000, the market began its precipitous drop. Nearly every investor, including the former clients of Mr. Pickett who had reentered the market, saw the value of their shares drop. Indeed, by the time of trial plaintiffs "would have been better off" if they had stayed with the reallocations Mr. Pickett made in October 1998. Tr. 9/17/02, K. Vincent at 470-72.

C. Plaintiffs File Their Lawsuit.

In September 1999, plaintiffs filed their putative class action. In 2001, this Court affirmed the trial court's certification decision, noting that, "the dominant issue is whether [PSI] is liable for selling the securities of its clients without prior authorization." *Burns*, 145 Ohio App. 3d at 430. But the trial court resolved that issue before the case reached the jury, granting plaintiffs' motion for partial summary judgment as to Mr. Pickett's and PSI's liability for breach of contract, breach of fiduciary duty, and conversion for the unauthorized trades. The trial court denied defendants' summary judgment motions, finding that their ratification defense could not be resolved without a trial, *see* Ruling (7/19/02), which commenced in September 2002.

Seating the jury, however, was no easy task. Given the number of class members and the modest size of the Marion community, many potential jurors knew parties in the case, leading to for-cause exclusions in a number of instances. *See* Tr. 9/11/02, Voir Dire at 34 (acquaintance of Pickett), 73 (friend of plaintiff Hutchins), 89-90 (mother is part of class action); Tr. 9/12/02, Voir Dire at 309 (knows "quite a few people" in class), 309-10 (knows people in class). One juror testified that she was the sister-in-law of a class member. *See id.* at 262 (Juror Worley). Over defendants' objection, however (and with plaintiffs' support, *see id.* at 267), the court refused to excuse her. With defendants out of preemptory challenges, she remained on the jury.

Equally troubling was the widespread pre-trial publicity associated with the case, which included at least seven articles in the *Marion Star* and local television coverage.[2] In discussing the case publicly before trial, plaintiffs' counsel frequently made highly prejudicial statements about Pickett and PSI. A host of potential jurors, at least one of whom ended up on the jury,

[2] *See Marion Star*, Feb. 1, 2001, at 5A ("'Prudential has dramatically stepped up its effort to reach victims and settle cases,' [Hargett] said. 'They're doing it in our opinion on nickels on the dollar.'"); *Marion Star*, Sept. 9, 2002, at 1A (Pickett's acts cost the "investors $15 million to $30 million they would have made if their equities had been left in the stock market, said Thomas Hargett, an Indianapolis attorney representing the investors.").

testified that they had read articles about the case in the *Star*. Tr. 9/11/02, Voir Dire at 83, 133.

Defendants repeatedly urged the court to ensure the trial's fairness. First, they moved unsuccessfully to change the venue. *See* Ruling on Motions to Change Venue (9/12/02). Second, to prevent future conflicts, they requested that the names of the class members be read to the potential jurors. Tr. 9/11/02, Voir Dire at 90-94 ("only takes four or five minutes"). To its credit, the trial court recognized the "appealable issue" that a denial would create. *Id.* at 94. Plaintiffs too recognized that "there are going to be people that know the class members," *id.* at 92 (Mr. Starr), and suggested that the court read the names once the jury had been selected. *Id.* at 91. The court agreed. *Id.* at 94 ("see if we think we got eight" and "then read the names").

As jury selection drew to a close, however, plaintiffs abruptly reversed course. Now claiming that they were "never . . . in favor of this," plaintiffs argued that it would be a "mistake to read the names," as it would "open up a complete can of worms." Tr. 9/12/02, Starr at 207-08, 211. Over defendants' objection, the court sided with plaintiffs. Tr. 9/12/02, Court at 212.

During trial, the inevitable came to pass. Juror Berry informed the trial court that a class member was her aunt. Tr. 9/18/02, at 540-41. Juror Judith Worcester told the court that a class member approached her in the parking lot and said, "Hi, Judy." *Id.* at 538-39. The class member, it turned out, was a former schoolmate. After holding a private conference with the two jurors (and without counsel present), the court permitted both to remain on the jury.

In the end, many of the class members' names were revealed to the jury – long after the jury had been selected and defendants had asked the court to address the issue in the first instance. Despite their earlier assertion that reading the names would open up a "can of worms," plaintiffs did just that, reading to the jury the names of more than 50 class members who had made oral complaints in 1999. Tr. 9/26/02, Dixon at 1561-62; Tr. 9/24/02, S. Vincent at 1426-27.

D. The Closing Arguments.

All of this was a prelude to a closing argument that crossed every line of fair play. First, counsel accused PSI of criminal conduct, urging the jury to punish PSI for it. Tr. 10/9/02, Starr closing at 1978 ("Does crime pay? So far it has."). There was no evidence of criminal conduct in this case, much less an allegation in the complaint. Second, counsel asserted that PSI improperly avoided regulatory sanctions. *Id.* at 2092 ("we all know that if you have connections . . . perhaps the regulators will look the other way. [E]vidently Prudential has great connections."). Again, there was no evidence nor an allegation that PSI improperly avoided any regulatory sanctions.

Third, plaintiffs' counsel violated two rulings of the court prohibiting references to "conduct of other corporate entities." *See, e.g.,* Ruling on Defendant's Motions in Limine (9/3/02), at 2-3. Counsel sought to taint PSI with the misconduct of others:

- "Is there any wonder that many of us have simply decided we can't trust the senior executives who are running many of American businesses." Tr. 10/9/02, Starr closing at 1978-79; and
- "You have the awesome once-in-a-lifetime opportunity to be part of the solution to the corporate ethics problems that plagues our nation." *Id.* at 1979.

Fourth, having laid the groundwork in opening that "our clients are your neighbors and friends here in Marion," Tr. 9/13/02, Starr at 13, counsel returned to this prejudice-inducing theme in closing. By alleging that PSI "misjudged the people of Marion" by thinking "that the good people [of] Marion" would not "dare take on one of the largest and most powerful corporations in the financial services industry," counsel compounded the error of allowing relatives and friends of the class to sit on the jury. Tr. 10/9/02, Starr closing at 1978.

Fifth, plaintiffs' counsel argued that a punitive damages award was needed to "send a message" not just to PSI but to the entire brokerage industry. Thus, he implored them:

- "You have the power to grab the attention of . . . the boards of directors of Smith-

Barney, and Merrill Lynch and Edward Jones and McDonald Investments and all the other brokerage houses who do business in this country." *Id.* at 1979;

- "I guarantee you that if you return an award of a billion dollars, it will be heard. It will be heard not only by Prudential, but it will be heard by every brokerage house that does business in this country." *Id.* at 1988.

Having been improperly asked to "send a message not only to Prudential but the entire brokerage industry," *id.* at 2092, the jury did just that.

E. The Verdict.

The jury awarded plaintiffs $11,740,994 on their contract claim and $5,905,598 on their tort claims. *See* Jury Interrogs. at 2, 4, 8. Because the contract and tort damages arose from the same conduct, plaintiffs were awarded the higher of the two. At plaintiffs' request, the contract damages were based upon application of the "New York Rule" of damages, which measures damages by the market high during a "reasonable" period after an unauthorized trade. Here, the jury determined that this period lasted *eight months*. Pl. Ex. 94. The jury also found that PSI acted maliciously in breaching its fiduciary duty and negligently supervising its employees. *See* Jury Interrogs. at 5, 10. For that, plaintiffs were awarded $250 million in punitive damages. Thereafter, the court denied defendants' post-trial motions for JNOV, new trial and/or remittitur.

ARGUMENT

I. AS A MATTER OF LAW, PLAINTIFFS RATIFIED THE TRADES (ASSIGNMENT OF ERROR NO. 1).

All agree that Mr. Pickett's conduct breached his clients' written agreements with PSI. In addition, the trial court held that Mr. Pickett's trades also violated duties he owed his clients in handling their non-discretionary accounts. But it is also agreed that, to the extent plaintiffs accepted the trades and thus "ratified" Mr. Pickett's conduct, their claims are barred. *See Jaksich v. Thomson McKinnon Sec.*, 582 F. Supp. 485, 497, 502 (S.D.N.Y. 1984) (Plaintiff's "knowledge of the wrong combined with her failure to object" meant she "ratified and waived the purchases of her stocks. Her inaction negated recovery under breach of fiduciary duty."). Here, the record proves that plaintiffs, after learning of the trades, did not object to them within either the time prescribed in their account agreements or a reasonable time thereafter.

A. Plaintiffs' Failure To Object To The Trades Constitutes Ratification.

"Where an agent purports to act for a principal without the latter's knowledge, the principal may nevertheless be liable on obligations arising from the transaction if the principal later adopts or ratifies the agreement arising from the transaction . . . with knowledge of its terms." *Ill. Controls, Inc. v. Langham*, 70 Ohio St. 3d 512, 522 (1994). "A principal ratifies the unauthorized acts of his agent when he does not take all steps reasonably and within his power to disaffirm promptly and effectively the unauthorized acts of his agent." *Franklin Park Lincoln-Mercury, Inc. v. First Fed. S.& L. Ass'n*, 73 Ohio App. 3d 452, 457 (6th Dist. 1991); *see also Morr v. Crouch*, 19 Ohio St. 2d 24, 29 (1969) (Ratification may be implied "from the client's negligence, inaction, or apparent acquiescence in" the unauthorized action.).

The ratification doctrine applies with particular force in unauthorized securities trading cases, where the financial ramifications of the unauthorized acts can change dramatically due to the markets' volatility. *Goldberg v. Kidder Peabody & Co.*, 991 F. Supp. 215, 218 (S.D.N.Y. 1997). That is why plaintiffs' agreements with PSI required them to act promptly if they disagreed with a trade. The Client Agreement required plaintiffs "to object in writing within 10 days" after learning of an unauthorized trade. Opening Account Agreement (Pl. Ex. 113). The confirmation slips sent to plaintiffs immediately after the trades stated that "execution of orders shall be conclusive if not objected to in writing addressed to the branch manager of the office serving this account within five days after transmittal to you by mail or otherwise." Client

Confirm. Slip (Pl. Ex. 115). And plaintiffs' monthly statements required objections to the report of transactions be made within ten days. Client Statement ("account statements sent to you shall be considered binding upon you if not objected to in writing within ten days") (Pl. Ex. 116).

Ratification clauses like these, which are commonplace in brokerage contracts, strike an important balance, allowing customers a reasonable period to object to a trade while preventing them from belatedly rejecting a transaction simply because the market moved against them:

> The purpose of the ten-day written complaint clause in the customer agreement is to require the customer to memorialize his or her complaint soon after receipt of the account statement *rather than waiting to see if the trade is profitable*. The writing requirement of the clause insures that unauthorized trading disputes are not relegated to "swearing contests" between broker and customer.

Modern Settings, Inc. v. Prudential-Bache Sec., 936 F.2d 640, 645-46 (2d Cir. 1991) (emphasis added). Indeed, the "requirement of prompt written notice of repudiation of trades has long stood as a pillar in the law of customer-broker relations." *In re The Drexel Burnham Lambert Group, Inc.*, 157 B.R. 539, 543 (S.D.N.Y. 1993).

Plaintiffs learned of the trades soon after they were made when they received their confirmations. Tr. 10/02/02, Tulman at 136-137. And defendants, through calls, meetings and a seminar, advised the clients of the trades and Pickett's reasons for making them. Yet no plaintiff told Pickett to reverse the trades in the weeks and months that followed, Tr. 9/18/02, Pickett at 689; Tr. 9/13/02, Stip. Facts at 8, a fact confirmed at trial by each named plaintiff.[3]

On this undisputed record, plaintiffs, as a matter of law, ratified the unauthorized trades. *Karat Gold Imports, Inc. v. United Parcel Serv.*, 62 Ohio App. 3d 604, 612 (8th Dist. 1989). The clients received their confirmation slips and monthly statements, knew the trades had been made,

[3] Tr. 9/20/02, Burns at 1081-83, 1090, 1104, 1106; Tr. 9/24/02, Burns at 1353-57 ("accepted" the trades); Halpin at 1457-58, 1460-62, 1490-91, 1501, 1531-32 (did not object to the trades; "probably thanked" Mr. Pickett for making them); Tr. 9/30/02, Hutchins at 190, 193-94, 212-13, 257, 271 (I "did not change what had been done").

knew they were unauthorized, knew Pickett's reasons for making them, and knew the state of the market. By opting to remain in the safer investments that resulted from the reallocations, they ratified the trades. *First City Sec. v. Shaltiel*, 44 F.3d 529, 532 (7th Cir. 1995) ("Having one's cake and eating it too . . . is not an option available in financial markets. . . . An investor who reads his monthly statements and fails to protest accepts the trades made in his account, notwithstanding a belated claim that the trades were unauthorized.").[4] There is no dispute that plaintiffs accepted the reallocations, which offered them less risk and less opportunity for reward. Having done so, they accepted the results of Pickett's acts and cannot now be heard to complain about them. *Morr*, 19 Ohio St. 2d at 29 ("Ratification may be implied from the fact that the client accepted the fruits of the [unauthorized trade] with knowledge thereof").[5]

B. Far From A "Continuing Duty," Defendants Owed Plaintiffs Only A Limited Duty to Complete The Transactions They Requested.

Plaintiffs' case is premised upon the theory that defendants owed their customers "special fiduciary duties," Tr. 10/9/02, Starr at 1943, and thus were obligated to give them additional market advice and inform them that PSI would reverse the trades at its expense. Plaintiffs further contend that, absent this counseling, they could not ratify the trades. This argument mistakenly expands the limited duties owed to plaintiffs, who had non-discretionary accounts.

"The duty of a broker to his customer is dictated by the discretion afforded the broker under the agreement." *Javitch v. First Montauk Fin. Corp.*, 279 F. Supp. 2d 931, 937 (N.D. Ohio 2003). "Although a broker operating a discretionary account – in which the broker determines which investments to make – is viewed as a fiduciary, . . . it is generally accepted that no

[4] *See also In re Klein, Maus & Shire, Inc.*, 301 B.R. 408, 419-20 (Bankr. S.D.N.Y. 2003); *Richardson Greenshields Sec. v. Lau*, 819 F. Supp. 1246, 1259-60 (S.D.N.Y. 1993); *Brophy v. Redivo*, 725 F.2d 1218, 1221-22 (9th Cir. 1984); *Ocrant v. Dean Witter & Co.*, 502 F.2d 854, 858-59 (10th Cir. 1974).

[5] Defendants also asserted the defenses of estoppel, waiver and laches based upon plaintiffs' failure to object to the trades. 10/9/02, Jury Inst. at 2105-10. For the same reasons, these defenses also bar plaintiffs' claims.

fiduciary duty arises between a broker and his client in relation to a non-discretionary commodity trading account." *J.C. Bradford Futures, Inc. v. Dahlonega Mint, Inc.*, 1990 WL 95625, at *5 (6th Cir. July 11, 1990) (quotation omitted). In other words, "[o]nly a broker operating a discretionary account – in which the broker determines which investments to make – is viewed as a fiduciary." *Commodity Futures Trading Comm'n v. Heritage Capital Advisory Servs., Ltd.*, 823 F.2d 171, 173 (7th Cir. 1987); *Kloss v. Edward D. Jones & Co.*, 54 P.3d 1, 9 (Mont. 2002) ("no fiduciary relationship"); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Boeck*, 377 N.W.2d 605, 608 (Wis. 1985) (no "fiduciary duty"). When a customer's account is "non-discretionary," there is "no fiduciary duty" owed by the broker to the customer. *Kegg v. Mansfield*, 2001 WL 474264, at *4 (Ohio Ct. App. 5th Dist. April 30, 2001) (awarding summary judgment to defendants on plaintiffs' breach of fiduciary duty claim; where broker and investors did not have any "discretionary authority" over plaintiff's account, it was non-discretionary, and thus broker and investors owed "no fiduciary duty" to plaintiff) (citation omitted).

The duties of a broker handling a non-discretionary account are "quite limited." *DeKwiatkowski v. Bear, Stearns & Co.*, 306 F.3d 1293, 1302 (2d Cir. 2002). "Duties to customers with nondiscretionary accounts are transactional in nature," *J.C. Bradford*, 1990 WL 95625, at *5, and are "exceedingly narrow." *Index Futures Group, Inc. v. Ross*, 557 N.E.2d 344, 348 (Ill. Ct. App. 1990). Brokers for those accounts buy what the client asks them to buy and sell what the client asks them to sell. A broker's limited duties "ordinarily end after each transaction is done, and thus do not include a duty to offer unsolicited information, advice, or warnings concerning the customer's investments." *DeKwiatkowski*, 306 F.3d at 1302.

If plaintiffs were correct, a customer could always concoct a fiduciary duty claim by pointing to some potentially relevant bit of information or opinion the broker failed to mention.

This unattainable standard for non-discretionary account brokers has already been rejected:

> But if a broker had a broad duty to furnish a nondiscretionary customer with all advice and information relevant to an investment, then . . . the customer could recover damages 'merely by providing nontransmission of some fact which, he could testify with the wisdom of hindsight, would have affected his judgment had he learned of it.

DeKwiatkowski, 306 F.3d at 1308 (quoting *Robinson v. Merrill Lynch*, 337 F. Supp. 107, 113 (N.D. Ala. 1971)); *see also Puckett v. Rufenacht, Bromagen & Hertz, Inc.*, 587 So. 2d 273, 280 (Miss. 1991); *Walston & Co. v. Miller*, 410 P.2d 658, 661 (Ariz. 1966). And for good reason: A rule that imposes liability for failing to provide "full knowledge of all the facts" of the account to a non-discretionary account client would destroy that limited – and very useful – relationship.

Nor did defendants owe plaintiffs the "continuing duty" that served as the basis for the $250 million punitive award. Tr. 9/19/02, Starr at 837. As PSI made clear at trial, there is no such duty. Tr. 10/7/02, Jury Instr. Conf. at 124. "We are aware of no authority for the view that, in the ordinary case, a broker may be held to an open-ended duty of reasonable care, to a nondiscretionary client, that would encompass anything more than limited transaction-by-transaction duties." *DeKwiatkowski*, 306 F.2d at 1306. Brokers in non-discretionary accounts have "no continuing duty" to advise their clients on the market, their investments, or their accounts. *J.C. Bradford*, 1990 WL 95625, at *5. "A broker has no continuing duty to keep abreast of financial information which may affect his customer's portfolio or to inform his customer of developments which could influence his investments." *Lieb v. Merrill Lynch*, 461 F. Supp. 951, 953 (E.D. Mich. 1978); *Puckett*, 587 So. 2d at 279; *Caravan Mobile Home Sales v. Lehman Bros. Kuhn Loeb*, 769 F.2d 561, 567 (9th Cir. 1985).

In other words, after Pickett informed his clients that the trades had been made, his duties came to an end. As plaintiffs' expert made clear, at that point it was up to the clients whether to accept or reject the trades. Tr. 9/30/02, Francis at 52. Thus, the trial court erred on two counts, first in failing to find ratification as a matter of law, and second in allowing plaintiffs to press a fiduciary duty theory that had no basis in law and that imposed the duties of a broker handling a *discretionary* account upon defendants, who were handling *non-discretionary* accounts.

II. THE COURT ERRED AS A MATTER OF LAW IN ITS INSTRUCTIONS ON RATIFICATION AND FIDUCIARY DUTY (ASSIGNMENT OF ERROR NO. 2).

At the very least, defendants deserve a new trial, as the court's ratification and fiduciary duty instructions were improper. For the fiduciary duty claim, the court instructed that it was defendants' duty "to make full, fair, and prompt disclosure of all facts within a broker's or brokerage firm's knowledge which a reasonable client would likely consider important in making an investment decision or a decision related to an investment." Tr. 10/9/02, Inst. at 2111. As to ratification, the court instructed that the "status as a fiduciary imposes upon a stockbroker and a brokerage firm an affirmative duty to inform his investor of all of the relevant facts relating to the subject matter of the managed investments that affect the investors' interest." *Id.* at 2105.

These broad instructions vastly overstated defendants' duties. Where a broker is accused of unauthorized trading, "[t]he jury should not, under the evocative phrase 'fiduciary duty,' be given carte blanche to decide any and all perceived transgressions, regardless of the law." *Hill v. Bache Halsey Stuart Shields, Inc.*, 790 F.2d 817, 825 (10th Cir. 1986) (remanding unauthorized trading case for new trial based upon flawed fiduciary duty instruction). Here, in the setting of a non-discretionary account, the law simply does not impose the duties reflected in the instructions.

In *J.C. Bradford*, a non-discretionary account customer accused a broker of unauthorized account activities. 1990 WL 95625. Instructing the jury on the fiduciary claim, the court stated that "the broker acquire[d] fiduciary duties towards the clients," including one "to make timely, full and complete disclosure of the facts that will benefit the principal." *Id.* at *5. The Sixth Circuit disagreed, holding that the instruction "incorrectly defined the scope of the [broker's] responsibility" and "improperly suggested that [the broker's] duty was more than transactional by indicating that [the broker] had a continuing duty to keep [the customer] informed of all developments in the market." *Id.* Equally fatal, the instruction outlined the broker's obligation "in sweeping, nebulous terms." *Id.* Due to these flaws, a new trial was granted.

The same is true here. Defendants had a duty to inform plaintiffs only that the unauthorized trades had taken place. *See Shearson Hayden Stone, Inc. v. Leach,* 583 F.2d 367, 372 (7th Cir. 1978) (where customer controlled his own account, "there was no fiduciary relationship, and thus the district court properly refused to instruct the jury on such a relationship"). The trial court's instruction demanded far more, requiring defendants to meet the duties of a discretionary broker. Accordingly, defendants deserve a new trial.[6]

III. THE COURT ERRED BY APPLYING THE NEW YORK (OR "CONVERSION") RULE TO THE CONTRACT CLAIM (ASSIGNMENT OF ERROR NO. 3).

Over defendants' objection, the trial court instructed the jury to apply the New York Rule (or "conversion" rule) to calculate plaintiffs' damages for the contract claim. Tr. 10/9/02, Jury Instr. at 2109; Tr. 10/1/02, Court at 178. Application of this rule allowed the class to measure damages against the market peak over the next eight months, leading to an additional $6 million in compensatory damages on the contract claim. The New York conversion rule, however, does not apply to contract claims. This error, reviewable by this Court *de novo*, *see Lucente v. IBM*

[6] The court also erred by refusing to instruct the jury on the contractual standard. The jury instructions failed to direct the jury on the standard for notice, objection and ratification of unauthorized trades – as carefully prescribed by the agreement between the parties. Because the parties contractually agreed to a process for ratifying or rejecting unauthorized trades, that standard – rather than a general legal standard – should have prevailed. Yet the contractual standard was never given to the jury. Tr. 10/9/02, Jury Inst. at 2104-05. Likewise, the court's refusal to instruct the jury that plaintiffs need only have had "constructive" knowledge of the material facts was erroneous and contrary to the law. *Id.* at 1926. It permitted the customers to ignore their trade confirmations, and thus to escape the ratification defense altogether, denying PSI the benefit of the protections for which it had contracted.

Corp., 310 F.3d 243, 261 (2d Cir. 2002), warrants reversal and remand. Even if this rule did apply, it does not allow the reasonable period for assessing damages to extend eight months.

A. The New York Rule Does Not Apply To Plaintiffs' Contract Claims.

Under the New York conversion rule, "the measure of damages for wrongful conversion of stock is either (1) its value at the time of conversion or (2) its highest intermediate value between notice of the conversion and a reasonable time thereafter during which the stock could have been replaced had that been desired, whichever of (1) or (2) is higher." *Schultz v. Commodity Futures Trading Comm'n*, 716 F.2d 136, 141 (2d Cir. 1983) (applying New York law). This rule is limited to claims for conversion of stock; as both Ohio and New York courts have made clear, the rule does not apply to contract claims.[7] Here, plaintiffs dropped their conversion claim before the case went to the jury. *See* Tr. 10/7/02, Jury Inst. Conf. at 22-24; 10/8/02, Jury Inst. Conf. at 1893. In doing so, they forfeited any entitlement to the conversion measure of damages under the settled law of both New York and Ohio. The trial court's jury charge on the New York conversion rule was a clear error of law.

Instead, plaintiffs' contract damages should have been calculated as of the time of the breach. "It is a fundamental proposition of contract law, including that of New York, that the loss caused by a breach is determined as of the time of breach. It is also fundamental that, where the breach involves the deprivation of an item with a determinable market value, the market value at the time of the breach is the measure of damages." *Sharma v. Skaarup Ship Mgmt. Corp.*, 916 F.2d 820, 825 (2d Cir. 1990); *accord Lucente*, 310 F.3d at 262 (in action for breach of

[7] *See Agostinelli v. DeBartolo Realty Corp.*, 2001 WL 1647218, at *7-9 (Ohio Ct. App. 7th Dist. 2001) ("New York does not recognize this so called New York damage theory in a cause of action for breach of contract.") (citation omitted); *Lucente*, 310 F.3d at 262 (rejecting conversion measure of damages in New York contract action); *Simon v. Electrospace Corp.*, 28 N.Y.2d 136, 144 (1971) (conversion measure of damages that calculates damages at some future point "has no application to a common breach of contract" securities claim).

stock option contract, rejecting conversion rule and endorsing "the traditional rule that damages for breach of contract are 'determined by the loss sustained or the gain prevented at the time and place of breach'") (quoting *Hermanowski v. Acton Corp.*, 729 F.2d 921, 922 (2d Cir. 1984)). While at first blush this may seem to result in damages of zero, in securities cases damages generally are measured from the time the injured party learned of the breach and was able to cover the loss. *Scully v. US WATS, Inc.*, 238 F.3d 497, 510 (3d Cir. 2001) (contract measure of damages in stock cases presupposes plaintiff's ability to cover); *Hermanowski*, 729 F.2d at 922 (damages for breach of securities contract are measured from "the date on or about which plaintiff learned that the defendant had breached the agreement").

Against this backdrop, the proper measure of contract damages is the increase in the value of plaintiffs' holdings between the date of the trades and the date when each plaintiff learned of them, allowing plaintiffs the increase in value of their shares during the period immediately after the reallocations. Plaintiffs, however, may not wait out a half-year bull market and then leverage Pickett's transgression into a massive return on an abandoned investment.

B. The Jury Erred In Calculating The Reasonable Period For Judging Plaintiffs' Contract Damages.

Even if the New York conversion rule governed the contract claim, it was misapplied here. In particular, the jury utilized an eight-month period that far exceeded any rational bounds of reasonableness. *See* Jury Interrog. at 2 (10/11/02); Pl. Ex. 94. The "reasonableness" requirement permits plaintiffs a much shorter period of time to exploit a market run-up after an unauthorized trade. *See Flickinger v. Harold C. Brown & Co.*, 789 F. Supp. 616, 620 (W.D.N.Y. 1992) ("a reasonable investor would contact his broker immediately upon discovery of missing stock and would contact his attorney shortly thereafter"). While the "appropriate time period varies somewhat with the facts of the case," *Katara v. D.E. Jones Commodities, Inc.*, 835 F.2d 966, 973 (2d Cir. 1987), typically the period is limited to a few days or a week.[8] "To permit a long reinvestment period would amount to allowing the customer to merely stand aside and watch the market [and] would give the customer a profit without his incurring the involved risk." *Letson,* 532 F. Supp. at 505 (quotation omitted).

The eight-month period plaintiffs were given to gauge the market far exceeded these limits, allowing them to take advantage of the greatest bull market ever. Thus, even if the Court somehow finds that the New York Rule applies, it should revise plaintiffs' contract damages to reflect a "reasonable period" that is consistent with the policies underlying the conversion rule and the precedents applying it. Alternatively, the Court should grant a new trial on this issue.

IV. THERE WAS NO LEGAL BASIS FOR A PUNITIVE DAMAGES AWARD.

A. Plaintiffs Asserted No Claim That Would Support A Punitive Award (Assignment of Error No. 4).

In addition to the flaws in the compensatory award, when it comes to punitive damages, there was no basis for such an award to begin with. Plaintiffs' case rested on a duty created by the brokerage contract – the duty only to make authorized trades in their non-discretionary accounts. But because all agree that this breach was not malicious, it could not support a punitive award. *See* Tr. 10/7/02, Starr at 31. Thus, in seeking punitive damages, plaintiffs were forced to argue that the brokerage contract created a broader fiduciary relationship between the parties – including the duty to give ongoing advice. As demonstrated above, however (at 13-16), it is clear that PSI had no such duty, continuing or otherwise.

[8] *See Caballero v. Anselmo,* 759 F. Supp. 144, 152 (S.D.N.Y. 1991) (ten days for stock conversion); *Flickinger,* 789 F. Supp. at 620 (ten days from the date of discovery); *Letson v. Dean Witter Reynolds, Inc.*, 532 F. Supp. 500 (N.D. Cal. 1982) (three days), *aff'd sub nom Shearson Loeb Rhoades, Inc. v. Bryant,* 730 F.2d 769 (9th Cir. 1984); *Modern Settings, Inc. v. Prudential-Bache Sec.*, 747 F. Supp. 194, 196 (S.D.N.Y. 1990) (three to five days), *aff'd* in part, *rev'd* in part (on other grounds), 936 F.2d 640 (2d Cir. 1991).

In the absence of such a fiduciary claim, plaintiffs have no legal basis for seeking punitive damages in this case. Plaintiffs did not seek a punitive damages award for their contract claim, nor could they have. *See Ketcham v. Miller,* 104 Ohio St. 372, syl. ¶ 2 (1922). A similar conclusion applies to plaintiffs' *negligent* supervision claim. Punitive damages in Ohio are limited to tort actions where the plaintiff has shown by clear and convincing evidence that the defendant acted with actual malice. *See* R.C. 2315.21(B) and (C)(2). They may not be based upon a claim of mere negligence or negligent supervision, as "something more than mere negligence is always required before an award of punitive damages may be made." *Cabe v. Lunich,* 70 Ohio St. 3d 598, 602 (1994) (quotations omitted); *accord Behrman v. Kryder Bros.,* 1996 WL 255874, at *2-3 (Ohio Ct. App. 3d Dist. May 13, 1996).

B. Even If There Were A Claim That Would Support A Punitive Award, Plaintiffs Failed To Prove Malice (Assignment of Error No. 5).

At all events, there was insufficient proof of malice to raise a jury issue. As applied here, "malice" amounts to "a conscious disregard for the rights and safety of other persons that has a great probability of causing substantial harm." *Preston v. Murty,* 32 Ohio St. 3d 334, 336 (1987). "Absent proof of a defendant's *subjective knowledge* of danger posed to another, a punitive damages claim . . . is not warranted." *Malone v. Courtyard by Marriot*, 74 Ohio St. 2d 440, 440 (1996) (emphasis added). And a plaintiff must prove malice by "clear and convincing" evidence. R.C. 2315.21(C)(2). Measured by this test, plaintiffs' punitive damages claim utterly fails.

The trial court upheld the punitive award based on the claimed omissions and other conduct that the jury had found breached the broad duty the court had imposed on PSI in the first instance. In particular, the court characterized as "intentional deception" and "disinformation" PSI's failure to advise plaintiffs that the trades were unauthorized and that PSI would bear the cost of their reentering the market as well as PSI's failure to offer plaintiffs the same investment advice that some PSI brokers were giving other customers. Judgment Entry, at 2-4, 6 (7/24/03). As an initial matter, plaintiffs were promptly notified of the trades and obviously knew they had not authorized them. Failure to advise them of that fact was therefore not even consequential – let alone malicious. Nor was the failure to tell plaintiffs that PSI would reverse the trades at its expense malicious. Indeed, until a client offered some indication that it wanted a trade reversed, the issue of who would pay was irrelevant. And certainly, to the extent they deemed it important, clients were free to ask who would pay to reverse the trades. As to investment advice, clearly it would not have been appropriate, much less required, for PSI to offer all its clients the same investment advice irrespective of their investment objectives, age, risk adversity, etc. In addition, Pickett's clients were looking solely to him for advice and gave no indication of any interest in what other PSI brokers may have thought. Tr. 10/1/02, Hutchins at 1670-72. Lastly, multiple witnesses testified that PSI did not engage in a "cover up" of Pickett's actions. Tr. 10/3/02, Roy at 1837-38; Tr. 10/3/02, Waddell at 1806; Tr. 9/20/02, Piatt at 1013; Tr. 9/23/02, Farley at 1184.

Other conclusions reached by the trial court in affirming a finding of malice also have no legal or factual basis. The conclusion that the class members "were unusually vulnerable," Judgment Entry at 4 (7/24/03), ignores the fact that the named plaintiffs had accounts worth hundreds of thousands of dollars, *see, e.g.,* Tr. 9/16/02, Van Meter at 173 ($700,000): Tr. 9/20/02, Burns at 1095 ($850,000), and, further, that the point of Mr. Pickett's actions was to make his clients *less* vulnerable, a fact his clients fully appreciated. *See* Tr. 9/19/02, Pickett at 714 (clients were grateful after the seminar); Tr. 9/17/02, K. Vincent at 472 (some plaintiffs told broker Vincent that Pickett was right). Likewise, the conclusion that plaintiffs' "emotional distress was immeasurable," Judgment Entry at 6 (7/24/03), ignores both the fact that no claim for emotional distress was made in this case and the fact that there was no evidence of it at trial.

Moreover, Ohio law requires a nexus between any alleged malicious act and the actual tort damages suffered by plaintiffs. R.C. 2315.21(B)(2); *Bishop v. Grdina,* 20 Ohio St. 3d 26, 28 (1985). Plaintiffs could not make this showing for the simple reason that the reallocations would have ultimately *benefited* them. Tr. 9/16/02, Van Meter at 257; Tr. 9/17/02, K. Vincent at 470-72. What had gone up would go down. And when the market crashed, plaintiffs would have been better off with Mr. Pickett's reallocations. Finally, even if PSI had an obligation to advise plaintiffs as they suggest, its failure cannot be said to constitute "subjective knowledge" of "a great probability" of substantial harm. As plaintiff Burns conceded, "[n]obody knows when the market's going to go up or down," Tr. 9/20/02, Burns at 1095. Thus, PSI could not know with "a great probability" that its failure to reverse the trades would cause substantial harm to plaintiffs. In truth, reversing the trades, the option that plaintiffs claims should have been given them, was the more harmful course; had that option been accepted, it would by the time of trial have made them *worse* off. This simply cannot be malice, to say nothing of $250 million worth of malice.

V. THE PUNITIVE AWARD IS UNCONSTITUTIONAL AND VIOLATES OHIO'S LIMITS ON PUNITIVE DAMAGES.

A. The Punitive Damages Award Violates The United States Constitution And Mandates A New Trial Or Drastic Remittitur (Assignment of Error No. 6).

The Fourteenth Amendment's Due Process Clause "prohibits the imposition of grossly excessive or arbitrary punishments." *State Farm*, 538 U.S. at 416. In *State Farm*, the Court held that a $145 million punitive award for an insurer's bad-faith failure to settle within the insured's policy limits violated due process. In doing so, the Court reaffirmed the three "guideposts" of excessiveness set forth in *BMW v. Gore,* 517 U.S. 559 (1996): (1) the degree of reprehensibility of the defendant's conduct; (2) the disparity between the harm suffered by the plaintiff and the punitive award; and (3) the difference between the punitive award and the civil or criminal sanctions that could be imposed for comparable misconduct. *State Farm,* 538 U.S. at 423-28.

Applying these principles, the Court observed that a $1 million compensatory award "was complete compensation" as the "harm arose from a transaction in the economic realm, not from some physical assault or trauma; there were no physical injuries." *Id.* at 426. The same is true here. No class member suffered physical assault or trauma; there were no physical injuries nor claims for emotional distress. In sum, this case, like *State Farm*, "is neither close nor difficult." *Id.* at 418. The blockbuster $250 million in punitive damages awarded here cannot survive the "[e]xacting appellate review" required by *State Farm. Id.*

1. Ratio: The over 40:1 ratio is excessive and unconstitutional.

"[P]erhaps [the] most commonly cited indicium of an unreasonable or excessive punitive damages award is its ratio to the actual harm inflicted on the plaintiff." *BMW,* 517 U.S. at 580. With this in mind, *State Farm* made clear that "[w]hen compensatory damages are substantial, then, a lesser ratio, *perhaps only equal to compensatory damages,* can reach the outermost limit of the due process guarantee." *State Farm*, 538 U.S. at 425 (emphasis added). In *State Farm*, where the compensatory award for claims of bad faith and intentional infliction of emotional distress was $1 million, the Court suggested that a 1:1 ratio between the punitive and compensatory damages would reach the limits of due process. Because the "compensatory award in this case was substantial, . . .[t]his was complete compensation." *Id.* at 426.

Similarly, this case involves a large compensatory award for an economic injury. It is not a case where assets were improperly placed in risky stocks that later crashed, with the broker earning a commission on the trades. To the contrary, defendants did not profit from the trades and plaintiffs' assets were simply moved from more risky to less risky holdings. In return, they received a more-than-full recovery – $6 million in compensatory damages on the fiduciary duty claim and nearly double that on the contract claim. In truth, because the contract award already doubled plaintiffs' recovery, thereby achieving the same effect as a punitive award based on a 1:1 ratio, there is no justification for any punitive award. *See State Farm*, 538 U.S. at 426 (punitive damages "likely were based on a component which was duplicated in the punitive award").

On the other end of the punitive spectrum, where compensatory damages are low and where the injury is physical rather than economic, a larger ratio between punitive and compensatory tort damages may be appropriate. But even that ratio rarely may exceed 3:1. *Id.* at 425 (noting "a long legislative history, dating back over 700 years and going forward to today, providing for sanctions of double, treble, or quadruple damages to deter and punish"). "[F]ew awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process." *Id.* In Ohio, where the legislature has attempted in the past to cap punitive awards at three times compensatory damages, a ratio of 3:1 or 4:1 is the outer due process limit. And these ratios, it bears emphasis, should be available only in cases of tragic personal injury coupled with low compensatory damages.

Here, the ratio of punitive to compensatory tort damages – over 40:1 – is nowhere near any of these limits. This difference not only indicates that the award is unconstitutional, but also explains why – the lack of reasonable notice to PSI that it could be subjected to such an off-the-charts penalty. "Elementary notions of fairness enshrined in our constitutional jurisprudence," *BMW* explains, "dictate that a person receive fair notice . . . of the severity of the penalty that a State may impose." 517 U.S. at 574. PSI had no such notice, which by itself establishes the unconstitutionality of the verdict.

2. Reprehensibility: PSI's conduct falls far short of the kind of reprehensibility that could support a large punitive damages award

State Farm also clarifies what kind of conduct establishes the degree of reprehensibility required to support a large punitive award. *State Farm* "instruct[s] courts" to consider specific criteria, including whether: "the harm caused was physical as opposed to economic; the tortious conduct evinced an indifference to or a reckless disregard of the health or safety of others; the target of the conduct had financial vulnerability; the conduct involved repeated actions or was an isolated incident; and the harm was the result of intentional malice, trickery or deceit, or mere accident." *State Farm,* 538 U.S. at 419. "The existence of any one of these factors," the Court adds, "weighing in favor of a plaintiff may not be sufficient to sustain a punitive damages award; and the absence of all of them renders any award suspect. It should be presumed a plaintiff has been made whole for his injuries by compensatory damages . . . ." *Id.*

In this instance, plaintiffs are hard pressed to show the existence of any one of these factors. The claimed harm caused was purely economic, not physical. The conduct did not evince a reckless disregard of the health or safety of others; indeed, these claims had nothing to do with health and safety. Plaintiffs hardly were a class of financially vulnerable individuals, and the reallocations themselves did not deprive plaintiffs of any value; on the contrary, Pickett's advice (if followed) would have saved them a lot of money, and *the whole point of Pickett's actions was to make plaintiffs less financially vulnerable.* This stands in sharp contrast to the typical broker trading case where the broker has placed the client in financial jeopardy, along the way generating a commission for himself.

The case, moreover, does not involve recidivist conduct; this was an isolated instance of unauthorized trading. There was no cover up and no deception. *See supra* at 22. The clients learned of the trades, received confirmation slips and statements, spoke with Mr. Pickett or other PSI employees, and attended a seminar, all within five weeks of the trades. The most that can be said is that PSI failed to follow up with each plaintiff in the manner plaintiffs say they should have, in other words, that plaintiffs were not fully informed of their right to reenter the market at PSI's expense or of PSI's market outlook. Even if these were required, such omissions fall short of the high standard for proving "reprehensibility." *BMW,* 517 U.S. at 580 ("omission of a material fact may be less reprehensible than a deliberate false statement"). This is particularly true when, like here, "there is a good-faith basis for believing that no duty to disclose exists." *Id.*

Against this backdrop, plainly no ratio greater than 1:1 can be justified. Indeed, *State Farm* is the harder case. There, the defendant went so far as to "alter[] the company's records," and the plaintiffs also asserted a claim based upon "a year and a half of emotional distress." *State Farm*, 538 U.S. at 410, 419, 426. Yet the Court still suggested that a 1:1 ratio represented the "outermost limit of the due process guarantee," *id.* at 425. Here, PSI made no false statements to its clients and had a good-faith belief that it had discharged its duties. And where the damage is entirely economic, a larger ratio is wholly unjustified. If a 1:1 ratio appeared adequate in *State Farm*, it surely is adequate here.

Nor may plaintiffs support this verdict based on the other grounds they promoted below, including out-of-state conduct and conduct of other corporations. *Id.* at 423-24. In *State Farm,* the case improperly "was used as a platform to expose, and punish, the perceived deficiencies of State Farm's operations throughout the country." *Id.* at 409. Here, however, plaintiffs went one step further, staining PSI with the *national misconduct of other corporations.* Tr. 10/9/02, Starr closing at 1979; *cf. State Farm*, 538 U.S. at 420 (counsel told jury to hold company "accountable for what it's doing across the country"). A "defendant's dissimilar acts, independent from the acts upon which liability was premised, may not serve as the basis for punitive damages," *id.* at 422, and the actions of other corporations can do so even less.

Likewise, any punishment must focus on the defendant and its conduct, not on its wealth or assets. *Mathias v. Accor Economy Lodging,* 347 F.3d 672, 676 (7th Cir. 2003) (law prohibits punishment based on status). Again, *State Farm* points the way: "The wealth of a defendant cannot justify an otherwise unconstitutional punitive damages award." 538 U.S. at 427. Here, plaintiffs' counsel argued just that. They relied on calculations of assets under management, *see* Tr. 10/9/02, Starr closing at 1959 (PSI "has assets of $235 billion"), and total assets, *see id.* at 1985 (PSI had assets "of 39 billion dollars"), which are not proper benchmarks for a punitive award. The former measures assets that belong to PSI's *clients*. And the latter may be used only after a showing that it is relevant to the "award's reasonableness or its proportionality to the harm," *State Farm*, 538 U.S. at 427, such as a showing that the defendant is likely to use its assets to avoid compliance with the law, *Mathias*, 347 F.2d at 677-78. Ignoring all of this, counsel used these figures to ask for $1 billion in punitives, misleading the jury into thinking that it was being "conservative" with its $250 million award. Tr. 10/9/02, Starr closing at 1985-88.

3. <u>Civil Penalties</u>: This punitive award bears no relation to the civil penalties that could be imposed for comparable conduct.

The third guidepost "is the disparity between the punitive damages award and the civil penalties authorized or imposed in comparable cases." *State Farm,* 538 U.S. at 428 (quotation omitted). Long before this lawsuit was filed, PSI reported the trades to the proper regulatory authorities and terminated the broker. And in fairly relying on the confirmation slips, monthly account statements, and governing agreements between the parties, PSI had a good faith reason to believe that plaintiffs had approved and ratified the trades.

It is thus not surprising that no regulatory sanction has been issued against PSI for Pickett's conduct. *See* Tr. 10/3/02, Roy at 1832. Even if a fine had been imposed, it would have paled next to the punitive award. Under R.C. 1707.99 (securities violations penalties), the maximum fine for securities violations is $20,000. Once again, this case parallels *State Farm*, where the most relevant civil sanction was a $10,000 fine. *See State Farm,* 538 U.S. at 428. Under *State Farm*'s third guidepost, this award likewise cannot stand.

* * * * *

All three *State Farm* guideposts establish the unconstitutionality of this award. Under *State Farm*, the permissible ratio in most cases is 1:1; it is 3:1 or 4:1 in egregious physical harm cases. Today's result is just the kind that *State Farm* precludes: "We have admonished that 'punitive damages pose an acute danger of arbitrary deprivation of property . . . . [T]he presentation of evidence of a defendant's net worth creates the potential that juries will use their verdicts to express biases against big businesses, particularly those without strong local presences." *Id.* at 417 (quotation omitted). That is exactly what happened here. Accordingly, the Court should vacate or drastically reduce this $250 million award.

B. Under Ohio Law, The Punitive Award Not Only Is Unconstitutional, But It Is Also Excessive (Assignments of Error Nos. 7 and 8).

Th punitive award also violates Section 16, Art. I of the Ohio Constitution, which ensures that verdicts be entered in accordance with "due course of law." Because the "Ohio Constitution is a document of independent force . . ., state courts are unrestricted in according greater civil liberties and protections to individuals and groups" than does the United States Constitution. *Arnold v. Cleveland,* 67 Ohio St. 3d 35, syl. ¶1 (1993). Indeed, "there has been a trend for state courts to rely on their own constitutions to provide broader protection for individual rights, independent of protections afforded by the United States Constitution." *State v. Robinette,* 80 Ohio St. 3d 234, 238 (1997). For the reasons just explained, the punitive verdict independently violates the Ohio Constitution, in addition to the due process guarantees of the U.S. Constitution.

In addition, the punitive award is plainly excessive and thus cannot stand under state law. Ohio law requires courts to correct two types of excessive judgments – those infected by passion and prejudice and those that are unsupported by the evidence. Where an award appears to have been given under the influence of passion or prejudice, a new trial is necessary. *See Moskovitz v. Mt. Sinai Med. Ctr.,* 69 Ohio St. 3d 638, 654 (1994). Even absent a finding of passion or prejudice, where the judgment is not sustained by the weight of the evidence, an appellate court may remand for a new trial. *Schendel v. Bradford*, 106 Ohio St. 387, 398 (1922). Alternatively, the court "has the inherent authority to remit an excessive award . . . to an amount supported by the weight of the evidence." *Wightman v. Consol. Rail Corp.,* 86 Ohio St. 3d 431, 444 (1999).

1. Comparing other punitive damages verdicts to this one demonstrates that this award is excessive and infected by passion or prejudice.

In determining whether a verdict was the result of passion or prejudice, Ohio courts compare the size of the award to other verdicts in the State. *See Shelton v. Greater Cleveland Reg'l Transit Auth.,* 65 Ohio App. 3d 665, 682 (8th Dist. 1989). In this case, the award exceeds the highest punitive verdict in Ohio by a factor of more than 60 for economic awards and more than eight for personal-injury awards. When compared with the conduct at issue in these other significant punitive damages verdicts, moreover, one is at a loss to explain the size of the award.

The vast majority of large awards in Ohio arise from personal injury claims, and are based on conduct far more egregious than anything that occurred here. The next highest reported punitive award, $30 million, involved a bad-faith insurance claim that arose from an unwarranted failure to provide insurance coverage for a dying woman. *Dardinger v. Anthem Blue Cross,* 98 Ohio St. 3d 77 (2002). In *Dardinger*, the defendant denied coverage to a patient with a brain tumor after initially approving the requested therapy, and then repeatedly delayed acting on the appeal of that decision despite knowing that the patient was having success with the therapy and that her condition had been aggravated by alternative treatments. *Id.* at 78-85. The patient died while awaiting coverage for the new therapy. *Id.* at 78 ("plaintiff claims that the way defendants handled Esther's chemotherapy needlessly shortened her life and caused her last days to be more painful than they should have been").

Even under these grim and extraordinary facts, the Court remitted the punitive award from $49 million to $30 million, *id.* at 105, emphasizing the defendants' exceptionally heartless conduct and the fact that the award arose from a personal injury rather than an economic one, noting that "we are dealing with human lives, rather than automobiles." *Id.* at 98 (defendants "took a dignified death from Esther Dardinger and filled her last days with frustration, doubt, and desperation"). The Court found that these actions "merit a historic punitive damages award" to "respect the fact that Anthem's bad acts were perpetrated on people who were in their most desperate state." *Id.* at 103. Comparing *Dardinger* to this case gives analogy a bad name. The former involved a compassionless response to the life-and-death predicament of a seriously ill patient; the latter concerns the benevolent reallocation of a stock portfolio.[9]

For economic-loss claims like this one, there are few large punitive verdicts in Ohio. In the only reported punitive-damage award of $4 million or more in this area, the conduct was far more recalcitrant and the award was far lower. In *Regal Cinemas v. Wolstein,* the plaintiff

[9] Other personal-injury cases are equally distinguishable from this case. *See Wightman,* 86 Ohio St. 3d 431; *Estate of Jason Monohan v. Peoples Cartage,* 1999 WL 33241887 (C.P. Oct. 12, 1999); *Yardley v. Colliflower,* 2002 WL 1354067 (C.P. Feb. 15, 2002). The latter two, it bears noting, were not subjected to appellate review.

recovered $4 million in punitive damages where the defendant developer fraudulently induced it to enter into a lease agreement with knowledge that the necessary permits to develop the leased site could not be obtained in a timely manner. 2001 WL 1689683 (N.D. Ohio Aug. 31, 2000). Here, plaintiffs' claims all are based on alleged *omissions* by PSI, not the type of intentionally tortious conduct at issue in *Regal Cinemas*. A comparison between that award and this one by itself confirms that the verdict here was the product of an unduly inflamed jury.

Not only is the *Dardinger* decision highly distinguishable on its facts, but its excessiveness holding also offers little direction here, as the Court's analysis did not benefit from the United States Supreme Court's subsequent decision in *State Farm*. In fact, the Court justified the "historic" award in *Dardinger* in part by relying on the $145 million punitive damages award upheld by the Utah Supreme Court in *Campbell v. State Farm Mut. Auto. Ins.*, 65 P.3d 1134 (Utah 2001). *See Dardinger*, 98 Ohio St. 3d at 102. The Utah decision, of course, was subsequently vacated by the United States Supreme Court. *See State Farm*, 538 U.S. at 418.

2. The passion and prejudice that influenced this verdict was the result of the actions of plaintiffs' counsel.

To determine whether an excessive verdict was influenced by undue passion and prejudice, courts do not hesitate to consider whether the conduct of counsel contributed to the problem. *Sindel v. Toledo Edison Co.*, 87 Ohio App. 3d 525, 531 (3d Dist. 1993). An excessive verdict "coupled with [] repeated appeals to passion and prejudice can lead to no other conclusion but that the verdict of the jury was one influenced by passion and prejudice." *Guccione v. Hustler Magazine, Inc.*, 1981 WL 3516, at *20 (Ohio Ct. App. 10th Dist. Oct. 8, 1981). Indeed, several Ohio courts have granted new trials where a verdict was clearly excessive and where there was improper conduct at trial. *See, e.g., Bennice v. Bennice,* 1986 WL 6690, at

*4 (Ohio Ct. App. 6th Dist. June 13, 1986) (comments labeling defendant's actions as "'dirty, rotten' and 'underhanded'" along with appeals to regional bias indicated verdict was influenced by passion and prejudice); *Guccione,* 1981 WL 3516, at *6; *Krejci v. Halak,* 34 Ohio App. 3d 1 (8th Dist. 1986); *Gray v. Gen. Motors Corp.,* 52 Ohio App. 2d 348 (8th Dist. 1977).

This same kind of misconduct, and more, occurred here. *See supra* at 7-10; *infra* at 35-40. In the end, plaintiffs obtained exactly what they carefully orchestrated: An extraordinary verdict from an inflamed jury seeking to punish the entire securities industry, if not all of corporate America. Ohio law does not permit such verdicts to stand.

3. Plaintiffs' reliance on inflated financial figures to establish a benchmark for punitive damages also requires a new trial.

Before trial, defendants moved to exclude evidence of the company's net worth in reference to punitive damages. The trial court, however, denied the motion. *See* Ruling on Defendant's Motions in Limine, at 5-6 (9/3/02). But *Dardinger* confirms that a defendant corporation's annual *net profits* – not net worth – are the proper benchmark for assessing the outer limits of a sustainable punitive damages award. *Dardinger,* 98 Ohio St. 3d at 103; *Gollihue v. Consol. Rail Corp.,* 120 Ohio App. 3d 378, 403 (3d Dist. 1997) (punitive award of less than two percent of defendant's "annual net profit" not excessive). Using net profits ensures that an award will "not go beyond what is necessary to achieve its goals," *Dardinger,* 98 Ohio St. 3d at 102, by providing an objective number for the jury to ascertain a defendant's actual resources.

Instead of looking to net profits, however, plaintiffs presented the jury with a series of inflated figures – $235 billion, the total *client* assets that PSI managed in 1997 (Tr. 10/9/02, Starr closing at 1959-60; Pl. Ex. 64), and $39 billion, PSI's total assets in 1999 (*id.* at 1985-87; Pl. Ex. 136-I). They then used these numbers to implore the jury that it would "take an award somewhere in the area of a billion dollars" to adequately punish PSI. Tr. 10/9/02, Starr closing at 1988. That inflated request was far from proper. Indeed, in Ohio an award "between one-fourth and one-third" of a defendant's net profit is excessive. *Dardinger*, 98 Ohio St. 3d at 103.

Here, it turns out, plaintiffs' own exhibits indicated that PSI's average annual net profit from the end of 1998 through the end of 2000 was roughly $60 million. Thus, this award more than *quadruples* PSI's average annual net profit during that period, *see* Pl. Ex. 136-I, a proportion 20 times greater than that which *Dardinger* found excessive. Plaintiffs' reliance on misleading financial figures, as opposed to net profits, by itself mandates a new trial.

4. At a minimum, this verdict must be drastically remitted

Even if the award had not been motivated by passion or prejudice, a remittitur is required. Just as there are few awards exceeding $10 million, and indeed no award approaching even $50 million (let alone $250 million), the practice in our State is to reduce excessive awards. *Shelton,* 65 Ohio App. 3d at 682-83. Considering that the highest punitive award in the State for an economic-injury claim is $4 million, a drastic remittitur is required to bring this verdict within the realm of sustainable awards. A remittitur not only would be consistent with the practice of Ohio courts, but it would also be consistent with the views of the Ohio legislature. One provision of the legislature's 1996 tort reform legislation established a punitive-damages limit of three times the compensatory award in the case. *See* Am. Sub. H.B. 350 § 2315.21(D)(1) (1996). While the entire law ultimately was invalidated, this provision of the bill along with the decisions of other juries and other Ohio courts remain the best evidence of the State's view on the outer limits of legitimate punitive damages awards.[10]

[10] Recent evidence suggests that the legislature has taken an even dimmer view of high punitive awards since the enactment of the 1996 legislation. In 2003, the Senate passed a bill (currently pending in the House) which, if enacted, would cap punitive damages awards at "the greater of the amount of the compensatory damages awarded to the plaintiff from that defendant or one hundred thousand dollars." Sub. Senate Bill 80, Sec. 2315.21(D)(2)(a).

VI. THE MISCONDUCT OF PLAINTIFFS' COUNSEL BEFORE AND DURING TRIAL REQUIRES A NEW TRIAL IN A NEW VENUE (ASSIGNMENTS OF ERROR NOS. 9 AND 10).

Plaintiffs' counsel's improper conduct not only caused an unprecedented punitive award, it also undermined, in this case, the very foundation of the judicial process. This misconduct independently requires a new trial on all claims.

A. The Pretrial Publicity.

Against the backdrop of a major trial involving hundreds of local residents held in what plaintiffs' counsel described as "a small, close-knit community," Tr. 10/9/02, Starr at 1963, counsel seemingly made every effort to guarantee that their hometown edge would culminate in a runaway verdict. To start, they ran an advertisement in the *Marion Star* soliciting clients by stating that Mr. Pickett had potentially violated the securities laws. *See* PSI's Motion to Change Venue, at 1 (9/11/02). Later, numerous members of the jury pool admitted reading *Marion Star* articles that quoted plaintiffs' counsel, including one member who ultimately sat on the jury. *See* Tr. 9/11/02, Voir Dire at 134 (juror Worcester states that after reading pre-trial articles, it "was my idea that they lost – eventually lost some money out of these"). PSI sought to neutralize these tactics by seeking to transfer the case in accordance with Civil Rule 3, which would have avoided the additional prejudice created by the jury composition and counsel's exploitation of local bias. *State ex rel. Dunbar v. Ham,* 45 Ohio St. 2d 112, 115 (1976). This point seemingly was not lost on the court. Tr. 10/3/02, Court at 1764 ("He's got a point about the size of this town."). Nonetheless, plaintiffs vigorously objected to moving the case, and the court denied the request.

B. The Conflicted Jury.

At trial, plaintiffs' counsel fully exploited the trial court's refusal to remove the case from what counsel described as this "close-knit community," making repeated references to the class members as the jurors' "neighbors and friends here in Marion." Tr. 9/13/02, Starr opening at 13 (the "evidence will be that our clients are your neighbors and friends here in Marion, Ohio, members of the class"). They emphasized the fact that class members worked for the same employers as the jurors. *Id.* at 13-14. And they started each class member's testimony by highlighting the fact that the witness was a longtime member of this close-knit community. *See* Tr. 9/13/02, Van Meter at 108-12; Tr. 9/16/02, Moser at 271-72; Tr. 9/20/02, Burns at 1066-67.

No less significantly, relatives and friends of the plaintiffs actually sat on the jury. They included a sister-in-law, *see* Tr. 9/12/02, Voir Dire at 262, and, as discovered during trial, a niece, *see* Tr. 9/18/02, at 540-42. Out of preemptory challenges, PSI could not unilaterally remove the first relative, *see* Tr. 9/12/02, Voir Dire at 267-70, and the second was discovered in the middle of trial. Yet even under these circumstances, neither the trial court nor opposing counsel was willing to remove these jurors or to read all of the class members' names to the jury to determine whether other conflicts existed. Indeed, to this day, no one fully knows whether other jurors may have had relatives or friends in the class.

In allowing jurors to award damages to relatives, the trial court prejudiced PSI's ability to receive a fair trial. These types of relationships, contrary to plaintiffs counsel's suggestion, *see* Tr. 9/12/02, Starr at 267 ("[d]oesn't even come close to challenge for cause"), are grounds for removal for cause. R.C. 2313.42(G). Indeed, in "extreme instances of juror bias" like this, where a "juror is a close relative of one of the participants in the trial," "it can be conclusively presumed that the jury was not impartial." *United States v. Gaitan-Acevedo,* 148 F.3d 577, 591 n.9 (6th Cir. 1998) (quotation omitted). Even where the relationship is less than familial, Ohio courts routinely exclude a prospective juror from hearing a case. And when such an individual sits on the jury, courts understandably allow the affected party the opportunity for a new trial.

See, e.g., McGarry v. Horlacher, 149 Ohio App. 3d 33, 39 (2d Dist. 2002); *Wolfe v. Brigano,* 232 F.3d 499, 502 (6th Cir. 2000); *Jenkins v. Bazzoli,* 99 Ohio App. 3d 421, 427-28 (10th Dist. 1994); *State v. Pearson*, 1984 WL 4355, at *3-4 (Ohio Ct. App. 12th Dist. March 12, 1984); *Helmick v. Netzley,* 12 Ohio Misc. 97, 98 (C.P. 1967). If one family member on the jury generally requires a new trial, surely two (or more) do as well.

Plaintiffs' counsel, and ultimately the trial court, resisted all efforts to allow defendants to discover any similar conflicts, even after jurors expressed concern about the likelihood of conflicts becoming apparent once the trial began. *See* Tr. 9/18/02, Conf. at 538-39 (juror Worcester); Tr. 9/12/02, Voir Dire at 161 (juror Cottrill). Indeed, after opining that reading the names to the jurors would be "opening a can of worms," *id.* at 207, 212 ("it's a mistake to read the names"), plaintiffs' counsel did just that. When the trial court reversed its pretrial holding that the names and other information contained in the verbal complaint forms were "hearsay and not admissible," Ruling on Defendant's Motions in Limine, at 2 (9/3/02), plaintiffs' counsel read to the jury the names of over 50 class members listed on those forms. Tr. 9/24/02, S. Vincent at 1426-27; Tr. 9/26/02, Dixon at 1561-62. Had jurors known all the names of the class members and been questioned on any potential conflicts, it is all but certain that the jury's composition would have been much different. *See Machamer v. Warner,* 1929 WL 2084, at *1 (Ohio Ct. App. 3d Dist. Jan. 31, 1929) ("[s]carcely any prudent lawyer would have permitted to remain on the jury, a person having such relationship and such intimate past contact with plaintiff").

C. The Closing Arguments.

The closing arguments offered by plaintiffs' counsel only worsened these problems. *See Jones v. Macedonia-Northfield Baking Co.,* 132 Ohio St. 341, 350 (1937); *Pesek v. Univ. Neurologists Ass'n,* 87 Ohio St. 3d 495, 501-02 (2000). Plaintiffs' counsel improperly exploited the pretrial prejudice they had created by:

(1) emphasizing the ties between the jury and plaintiffs (Tr. 10/9/02, Starr closing at 1978);

(2) erroneously claiming that PSI had "assets of $235 billion dollars" to encourage the jury to think that it was being conservative in awarding a mere $250 million; (*id.* at 1959) and

(3) baselessly accusing PSI of criminal conduct and Enron-like behavior (*id.* at 1978 - 1979 ("Does crime pay? So far it has").

On this last point, these actions were far more egregious than imploring a jury to issue an award "based on the public demand to stamp out . . . evil," which was held to be improper. *State v. Cloud,* 112 Ohio App. 208, 214 (8th Dist. 1960); *accord State v. Agner,* 30 Ohio App. 2d 96 (3d Dist. 1972); *Clark v. Doe,* 119 Ohio App. 3d 296, 307 (1st Dist. 1997).

This overheated rhetoric violated a pretrial order prohibiting references to other corporate misconduct. Plaintiffs instead painted with the broadest of brushes, asking the jury to punish PSI for *all* corporate misconduct. Tr. 10/9/02, Starr closing at 1979 ("You have the awesome once in a lifetime opportunity to be part of the solution to the corporate ethics problems that plagues our nation."); 1978-79 ("Is there any wonder there is such a crisis of confidence in our large corporations in this country today?"). This alone tainted the proceedings. *Igo v. Coachmen Indus.,* 938 F.2d 650, 653 (6th Cir. 1991) (new trial where counsel's misconduct included references to evidence excluded by an in limine ruling and statements in closing that defendant was a "billion-dollar corporation," made "to demonstrate that [it] could pay a big verdict").

And as a collective matter, these tactics demand a new trial. That was the result in another case where the plaintiff's counsel referred to his opponent in closing as a "big city lawyer from Cleveland [who] comes down here and tries to tell you different," told the jury that defendants "got to think we're country bumpkins," and accused his opponents of "lying" and making records disappear. *Stephen's Jewelry, Inc. v. Admiral Ins. Co.*, 63 Ohio App. 3d 213, 217-19 (11th Dist. 1989). That and worse occurred here. Tr. 10/9/02, Starr closing at 1948, 1955 (pitting "top New York management in New York, senior management" against "the good people of Marion"), 2092 ("if you feel like me, something stinks, and its not these fine people here in Marion, Ohio, then I suggest that you send a message to these people"), 1935 (accusing PSI employee of having "a brain injury"), 1937 (alleging that "the best way to avoid shredding documents later is not to create any documents in the first place" although there was no evidence of shredding here).

PSI, in short, never had a chance in this case. Counsel's improper tactics, and the resulting punitive award, are precisely the type of "acute danger of arbitrary deprivation of property" posed by punitive damages. *State Farm,* 538 U.S. at 417 (noting "potential that juries will use their verdicts to express biases against the big businesses, particularly those without strong local presences") (quotation omitted). At a minimum, defendants deserve a new trial, conducted in a fair manner, with a properly seated jury.

VII. THE CLASS SHOULD BE DECERTIFIED (ASSIGNMENT OF ERROR NO. 11).

Three years ago, this Court affirmed the initial class certification based on plaintiffs' assurance that the predominant issue at trial would be "whether Prudential is liable for selling the securities of its clients without prior authorization." *Burns*, 145 Ohio App. at 430. As plaintiffs' counsel freely admitted later, however, their assurances were misplaced. *See* Tr. 10/7/02, Starr at 31-32. The predominant issue at trial, it turned out, was *not* liability for the initial trades in October 1998, but the interaction between PSI and its customers in the months that followed.

Plaintiffs' post-certification switch in theories rendered this case inappropriate for class treatment, as the trial focused on individualized questions of ratification and each plaintiff's knowledge as it related to PSI's alleged continuing duty to provide information. Contrary to the decision below, these individualized issues are not susceptible to class treatment. *Petty v. Wal-Mart Stores, Inc.*, 148 Ohio App. 3d 348 (2d Dist. 2002); *Hall v. Jack Walker Pontiac*, 143 Ohio App. 3d 678 (2d Dist. 2000). Under plaintiffs' new theory, "an individual determination would have to be made in every case as to what the [client] was told" and how she responded. *Marks v. C.P. Chem.*, 31 Ohio St. 3d 200, 206 (1987). With this in mind, the court abused its discretion by not decertifying the class. *Baughman v. State Farm Mut. Auto.*, 88 Ohio St. 3d 480 (2000).

A. If At Any Point Following Initial Certification The Predominant Issues Turn On Individualized Facts, The Class Must Be Decertified.

Because this case was certified under Civil Rule 23(B), plaintiffs were required to show that common issues at all times predominated. "If each cause of action requires individualized proof . . . then common questions do not predominate." *Hall*, 143 Ohio App. 3d at 687 (citation omitted). Thus, where the case turns on elements "individual to each putative plaintiff," the class may not be certified under Rule 23(B). *Petty*, 148 Ohio App. 3d at 356; *Marks*, 31 Ohio St. 3d at 206. These requirements apply with equal force after the initial certification decision. If at any time the predominant case issues become individualized, the class must be decertified. *See Liggett Group v. Engle*, 853 So. 2d 434, 440 (Fla. Ct. App. 2003) (decertifying class it earlier certified); *Daenzer v. Wayland Ford, Inc.*, 210 F.R.D. 202, 204-05 (W.D. Mich. 2002) (class may be decertified "for proper reason" at any point); *Beckert v. TPLC Holdings, Inc.*, 221 F.3d 870 (6th Cir. 2000) (decertifying class); *In re Am. Med. Sys., Inc.*, 75 F.3d 1069 (6th Cir. 1996).

B. As Revealed At Trial, Plaintiffs' Claims And Actions Were Inherently Individualized And Not Susceptible To Class Proof.

This Court previously affirmed class certification because "the dominant issue is whether Prudential is liable for selling the securities of its clients without prior authorization." *Burns*, 145 Ohio App. 3d at 430. Yet at trial, the dominant issue shifted to whether PSI violated an alleged ongoing duty to provide information to the class. The reason for the shift was simple: plaintiffs could not recover punitive damages for the unauthorized trades alone, which constituted a mere breach of contract and were admittedly made without malice. Thus, their counsel turned to the ongoing duty theory in an attempt to posit some basis for a punitive award.

This sea change rendered the case unfit for class treatment, as at least two questions of individualized fact came to dominate the trial. First, an "ongoing duty" claim turns on how and when each plaintiff learned of the trades and what each plaintiff knew about their asserted rights. As the evidence revealed, plaintiffs learned of the trades in various ways, including confirmation slips, calls to or from Mr. Pickett or other PSI employees, meetings with Pickett, monthly statements, and the seminar. As a result, to the extent plaintiffs' claims depended upon what each plaintiff knew and when she knew it, "the same conduct" did not create each claim. *Burns*, 145 Ohio App. 3d at 430; *see also Marks*, 31 Ohio St. 3d at 206. Equally true, at trial plaintiffs argued that the class had to be told about their alleged "right" to re-enter the market at PSI's expense and had to be given "full information" about the market. Even if this were true as a legal matter, and it plainly is not, for purposes of class certification analysis, *the class was varied with respect to this knowledge as well.* In fact, broker Ken Vincent testified that the class was divided into thirds in terms of sophistication and that some class members *did* believe PSI would reverse the trades at its cost if they so requested. Tr. 9/16/02, K. Vincent at 325-31. If the clients' knowledge (or lack thereof) affected their ability to ratify, PSI should have been given the chance to establish whether and what each class member in fact knew about PSI's practice of reversing trades as well as current market conditions and future forecasts.

Second, ratification is a mental state unique to each client, and the record demonstrates that each client ratified the trades in a unique manner. While Mr. Burns ratified the unauthorized trades over lunch with Mr. Pickett, *see* Tr. 9/20/02, Burns at 1081-83, class member Mr. Van Meter ratified the trades in a telephone call. Tr. 9/13/02, Van Meter at 126-128. And while Mr. Halpin ratified the trades and thanked Mr. Pickett for making them, *see* Tr. 9/25/02, Halpin at 1457-58, Mr. Hutchins, on the other hand, "reluctantly accepted" them during a conversation with Mr. Pickett. Tr. 9/30/02, Hutchins at 212. Some clients attended Pickett's seminar; some clients met with him in person. Some clients had no communication with PSI regarding the trades; others not only affirmatively ratified but also thanked Pickett for making them. Even if plaintiffs could show that *one* named plaintiff failed to ratify the trades – which they have not – that evidence does nothing to prove whether any other class member did or did not ratify.

All told, liability for the initial trades was not the predominant question at trial. Class treatment denied PSI its right to address fully the individualized determinations on which the case ultimately turned. *See Wal-Mart Stores, Inc. v. Lopez*, 93 S.W.3d 548, 558 (Tex. Ct. App. 2002) (defendant has right to inquire into validity of each plaintiffs' claim and to present individualized defenses). The class should be decertified.

C. Compensatory And Punitive Damages Could Not Be Awarded In The Absence Of Individualized Determinations Of Harm.

Even if PSI did owe a duty that lasted long after the reallocations, plaintiffs nevertheless failed to prove injury and causation. According to plaintiffs, because PSI's continuing duty breach lasted until April 1, 1999, when Pickett was replaced by other brokers, each class member's damages should be measured by the difference in share prices during that period. Tr. 10/2/02, Tulman at 45. Yet plaintiffs failed to prove that the claimed breach injured any class member or the extent of such injury. Because causation, injury and damages from nondisclosure are inherently matters of *individualized proof*, they could not be proved on a classwide basis.

Indeed, plaintiffs offered no proof that the entire class changed position to its detriment based on the nondisclosure. At a minimum, that would have required proof that plaintiffs, upon learning of the alleged option to repurchase their prior holdings at no expense, would have done so. In truth, many would not; the testimony established that many class members preferred in October and November to be in lower-risk securities. Tr. 9/20/02, Burns at 1089; Tr. 9/25/02, Halpin at 1457-62; Tr. 9/30/02, Hutchins at 212-13. And even if certain plaintiffs could have proven that they would have repurchased their shares then, the only ones entitled to damages for the capital gain in those shares between October and March are those who could prove (without speculation) that they would have *realized* that capital gain – which would have required proof that they would have held the repurchased securities from October and then *sold* them in March. Few if any class members could have established that fact, as the evidence was that many of the class members *continued* to hold equities after March. *See* Tr. 9/24/02, Burns at 1356.

Plaintiffs never introduced any relevant evidence on individual injury, damages, and causation, relying instead on the invalid and illogical theory that classwide damages are measured by the period of the putative breach of fiduciary duty. This Court itself noted in its initial review that "there is no question that a great deal of time will be spent determining the amount of liability, if any, for each client." *Burns,* 145 Ohio App. 3d at 431. *Critically, that client-by-client inquiry never happened.*

Likewise, the punitive damages award was not based on individualized proof of the harm to the plaintiffs, nor did it turn on each client's vulnerability (or lack thereof). Punitive damages must be proportionate to the individual harm suffered. *State Farm,* 538 U.S. at 426 ("[c]ourts must ensure that the measure of punishment is both reasonable and proportionate to the amount of the harm of the plaintiff"). Where class treatment of punitive damages prevents an individualized proportionality determination, the award may not stand. *Allison v. Citgo Petroleum Corp.*, 151 F.3d 402 (5th Cir. 1998) (class determination of punitive damages inappropriate where structure of damages award precludes individualized determinations); *Engle,* 853 So. 2d at 450 (class award of punitive damages divorced from individualized determination of liability is unconstitutional under *State Farm*). Here, the structure of the punitive award prevented any individualized determination of proportionality. Thus, the award must be vacated.

VIII. UNDER SLUSA, THE TRIAL COURT DID NOT HAVE JURISDICTION OVER THIS CLASS ACTION (ASSIGNMENT OF ERROR NO. 12).

The Securities Litigation Uniform Standards Act, or SLUSA, precludes state law class actions that allege a "misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1)(A). Class claims covered by the statute may not be pursued in state court; any "covered class action brought in any state court involving a covered security . . . shall be removable" to federal court. 15 U.S.C. § 78bb(f)(2).

The trial court erred in holding that it had jurisdiction to hear this securities class action. Plaintiffs' ongoing duty claim is premised squarely on the notion that PSI made omissions and misstatements in connection with Mr. Pickett's unauthorized trades. In fact, plaintiffs' primary claim was that PSI either misrepresented or omitted the fact that plaintiffs could reverse the trades at the company's expense. This same theme dominated their closing argument:

- "If they would have been told the true facts from the beginning, they would have been upset much sooner." Tr. 10/9/02, Starr closing at 1935.
- "[O]ur clients did not have full knowledge of all the information." Tr. 10/9/02, Meyer closing at 1991-92.
- "They didn't receive anything other than the justification for the trades." *Id.* at 1932.

If these are not allegations of omissions and misrepresentations, it is hard to know what is. Thus, although the federal district court held that SLUSA did not apply here, which it plainly does, this Court should dismiss the case due to the lack of jurisdiction in state court. *See Shaw v. Charles Schwab & Co.*, 2003 WL 1463842, at *4 (Cal. Sup. Ct. Mar. 7, 2003) (SLUSA preempts state law class claims after remand order from federal court); *accord* Appellant Pickett's Br. at 21-24.

CONCLUSION

All told, this verdict is not just wrong, it is shockingly wrong. Accordingly, the Court should reverse the judgment below and remand the case for entry of judgment for defendants on all of plaintiffs' claims. Alternatively, the Court should:

- vacate the judgment below and dismiss the case for a lack of jurisdiction;
- vacate the judgment below, decertify the class, and remand the case for further proceedings;
- (1) vacate the contract damages award and remand the case for entry of judgment on the contract claim in accordance with the proper measure for contract damages and (2) vacate the punitive damages award and remand the case for entry of judgment for PSI on the punitive damages claim or remit the punitive award to an amount not greater than the compensatory tort damage award of $5,905,598; or
- vacate the judgment below and remand the case for a new trial in a new venue before a properly instructed jury on all of plaintiffs' claims.

Respectfully submitted,

Patrick F. McCartan / by [signature]

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CERTIFICATE OF SERVICE

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