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Securities Litigation ADVISORY ■

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A New Class Action Theory for Breach of Fiduciary Duty by Brokers Recommending Variable Annuities Is Being Advanced, But Should Not Survive

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A class action was recently filed in the U.S. District Court for the Northern District of Georgia against a variable annuity company and its captive broker-dealer asserting a novel theory of classwide liability for purported breach of fiduciary duty because the broker-dealer recommended its parent's variable annuity investments for customers' tax-qualified retirement plans. The theory plays off the plaintiffs' bar's success in ERISA fee cases[1] by cobbling together the all-too-familiar saw about the unsuitability and expense of variable annuity products for tax-advantaged accounts and an expansive reading of dicta from a 2010 Supreme Court of Georgia decision about the nature and scope of a broker's fiduciary duty to its customers in nondiscretionary accounts. The plaintiff's lawyer in the case has indicated he may be filing similar actions against other firms.

The complaint seeks the certification of the class of "all Georgia residents who purchased an individual variable deferred annuity contract or who received a certificate to a group variable deferred annuity contract issued by [the defendant], or who made an additional investment through such a contract, within the applicable statute of limitations that was used to fund a [tax-qualified retirement plan]." The complaint then alleges that the defendants "owed fiduciary duties" to the class members and breached those duties "by providing investment advice that was not in customers' best interest in an effort to steer class members' money into variable annuities that would pay higher fees to" the defendants.

The broad fiduciary duty the complaint depends on comes from dicta in the last two sentences of the Supreme Court of Georgia's decision in *Holmes v. Grubman*, 286 Ga. 636 (2010). The *Holmes* opinion is the product of the Supreme Court of Georgia's answers to the Second Circuit's certified questions concerning the viability of "holder" claims for fraud, negligent misrepresentation, and breach of fiduciary duty under Georgia common law. The plaintiff in *Holmes* was a Salomon Smith Barney customer who relied on the broker's false statements about the value of the customer's

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1 Federal class actions brought under the Employment Retirement Income Security Act of 1974 (ERISA) by plan participants against ERISA plan fiduciaries for choosing relatively expensive investment options for the plan.

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substantial holdings of Worldcom Inc. stock, and the broker's failure to disclose its conflict of interest as Worldcom's investment banker, in deciding to hold, rather than sell, those shares. In the opinion's last two sentences, the Supreme Court of Georgia wrote:

> However, we further conclude that the fiduciary duties owed by a broker to a customer with a non-discretionary account are not restricted to the actual execution of transactions. The broker will generally have a heightened duty, even to the holder of a non-discretionary account, when recommending an investment which the holder has previously rejected or as to which the broker has a conflict of interest.

In pursuing classwide treatment, the lawsuit assumes equivalence between the rigid and uniform fiduciary duty imposed on ERISA plan fiduciaries and the *Holmes* Court's recognition of the limited fiduciary duty owed by a broker to its customer under Georgia common law. But in doing so, the complaint's theory conveniently ignores the myriad individualized circumstances and considerations that inform and define a broker's relationship with each of its customers. And further, the complaint's theory improperly conflates the concepts of disclosure and suitability by implying that the defendants could not satisfy their duties to their customers by fulsome disclosure (which is not alleged to have been deficient), but rather only by recommending different, less expensive investment products. It is for these reasons, among others, that the theory is unlikely to gain traction as the basis for a class action against the variable annuity company and its captive broker-dealer.

While this novel theory seems unlikely to take hold under the current state of the law, if nothing else, it foreshadows one variation of many new theories that may substantially increase the litigation risk financial services firms will face in the fast-approaching epoch of the SEC's best interest standard and numerous states' codifications of fiduciary standards for brokers.

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