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J. Frank Burdick; Jimmy V. Henrie; Grant B. Howell; Ella Dean Hunter; Terry L. Jordan; Ricahrd Manus; Teresa Manus; Michael Marquez; Teri Marquez; Lurene Swinburne, Personal Representative, for and on behalf of the Estate of robert D. Swinburne; and Wylma Temples v. Hornor, Townsend & Kent, Inc; Jeffrey C. Campbell; Five Star Financial Group : Reply Brief of Appellants

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**IN THE SUPREME COURT FOR THE STATE OF UTAH**

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J. FRANK BURDICK; JIMMY V.  
HENRIE; GRANT B. HOWELL; ELLA  
DEAN HUNTER; TERRY L. JORDAN;  
RICHARD MANUS; TERESA MANUS;  
MICHAEL MARQUEZ; TERI  
MARQUEZ; LURENE SWINBURNE,  
PERSONAL REPRESENTATIVE, FOR  
AND ON BEHALF OF THE ESTATE OF  
ROBERT D. SWINBURNE; and WYLMA  
TEMPLES,

Appellants,

vs.

HORNOR, TOWNSEND & KENT, INC.;  
JEFFREY C. CAMPBELL; FIVE STAR  
FINANCIAL GROUP,

Appellees.

Appellate Court No. 20110479

Civil No. 060700588

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**REPLY BRIEF OF APPELLANTS**

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**APPEAL FROM THE SEVENTH JUDICIAL DISTRICT COURT OF CARBON  
COUNTY, STATE OF UTAH, JUDGE DOUGLAS THOMAS**

---

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UTAH APPELLATE COURTS

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**The following parties to the district court proceedings (Campbell Case) are also parties in this appeal:**

J. Frank Burdick — Plaintiff-Appellant

Jimmy V. Henrie — Plaintiff-Appellant

Grant B. Howell — Plaintiff-Appellant

Ella Dean Hunter — Plaintiff-Appellant

Terry L. Jordan — Plaintiff-Appellant

Richard Manus — Plaintiff-Appellant

Teresa Manus — Plaintiff-Appellant

Michael Marquez — Plaintiff-Appellant

Teri Marquez — Plaintiff-Appellant

Lurene Swinburne, Personal Representative for Estate of Robert D. Swinburne -Plaintiff -  
Appellant

Wylma Temples — Plaintiff-Appellant

Hornor, Townsend & Kent, Inc. — Defendant-Appellee

Jeffrey C. Campbell — Defendant — Appellee

Five Star Financial Group — d/b/a of Jeffrey C. Campbell — Defendant - Appellee

**The following parties to the district court proceedings are not parties in this appeal:**

Loralie Thayn — Plaintiff

Frank C. Wheeler — Defendant

Cambridge Financial Advisors, LLC d/b/a Cambridge Financial Center — Defendant

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Appellants appeal the trial court's grant of summary judgment, denial of reconsideration, and related evidentiary rulings arising out of their claims against Hornor, Townsend & Kent ("HTK"). Appellants invested in Beverly Hills Development Company ("BHDC"), a promissory note scam sold through Five Star Financial. Five Star was HTK's authorized office in Price, Utah. Appellants sued HTK for vicarious liability stemming from the conduct of its agents and apparent agents, and direct liability for its own negligent conduct relating to Five Star and BHDC.

## **ARGUMENT**

### **I. HTK'S MANIFESTATIONS OF CONSENT AND APPELLANTS' BELIEF AND RELIANCE THEREON ARE QUESTIONS OF FACT**

#### **A. HTK Manifested its Authority**

Appellants presented evidence HTK manifested its consent of authority in numerous ways, including authorizing the Five Star agents to solicit and effect securities transactions, give investment advice, use HTK forms, and advertise and hold themselves out as HTK representatives. *See* Initial Brief at 9-22; Restatement (Second) Agency § 8, cmt(b); § 27. HTK argues this evidence is insufficient because it does not manifest authority to sell BHDC. Opp at 12. This argument misses the point because, "even though an agent's act is not actually authorized by the principal, the principal may nevertheless be liable to a third party based on the doctrine of apparent authority." *Luddington v. Bodeninvest, Ltd.*, 855 P.2d 204, 208 (Utah 1993). No actual authority to sell BHDC was required.

## **B. Appellants Believed HTK's Manifestations of Authority**

HTK next argues each appellant's belief in Campbell's apparent authority was unreasonable. Reasonableness is generally a question of fact. The Restatement (Third) of Agency explains, "apparent authority is based on a third party's understanding of signals of all sorts concerning the actor with whom the third party interacts. . . It is usually a question for the trier of fact whether a reasonable person in the position of a third party would believe that an agent had the authority or the right to do a particular act. It is a separate but related question of fact whether such a belief is traceable to a manifestation of the principal." § 2.03, cmt. (d). Each appellant raised questions of fact regarding their belief the Five Star agents were authorized which must be determined by a jury.

Burdick: HTK labels Burdick's evidence "revisionist history," arguing Campbell's authorized dealings with Burdick as a registered representative of HTK cannot be attributed to HTK. Opp at 16. That is incorrect. It is "self-evident that a corporation can act and be acted upon only through its agents." *Industrial Comm'n v. Kemmerer Coal Co.*, 150 P.2d 373, 375 (Utah 1944). Thus, Campbell's authorized representations to Burdick in the furtherance of soliciting and effecting securities transactions were representations made by HTK.<sup>1</sup> See Initial Brief at 9-11.

Temples: HTK dismisses appellant Temples' evidence arguing she "recanted" her

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<sup>1</sup> HTK also argues Burdick's assumption that HTK was still involved in his investments was "unreasonable." Opp at 17. This must be determined by the jury, not a trial court on summary judgment.

testimony. Opp at 19. The record demonstrates otherwise. Mrs. Temples, on page 66 of her deposition, testified she understood BHDC was authorized by HTK because HTK had authorized her previous investments and she was not told anything different at her first meeting about BHDC. [TR3473, lines 12-22]<sup>2</sup> HTK claims she recanted this testimony on the next page when she testified she did not know if Campbell was authorized to sell BHDC at that first meeting. [TR3473, lines 13-25] Yet, on page 165, Mrs. Temples confirmed she always thought HTK was involved with BHDC:

A: I always knew that they were there. I mean, their name was on the door from the very first.

Q: But when's the first time you remember connecting them in your mind to the sale of Beverly Hills Development Corporation?

A: Probably when Jeff [Campbell] started talking about it. I mean, I never did – disassociated them, I guess is what I'm saying.

[TR3537, lines 8-16] Mrs. Temples may not have produced unequivocal testimony, but she did not have to. Mrs. Temples produced sufficient admissible evidence to submit her claim to the jury. The trial court's ruling to the contrary was error.

Marquez: HTK argues "it is undisputed that HTK made no manifestations to the Marquezes." Opp at 20. This is incorrect. HTK held Frank Wheeler out as its registered representative, authorized to recommend, solicit and effect securities transactions. *See* Initial

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<sup>2</sup> HTK argues Mrs. Temples' belief was unreasonable because her HTK-approved investments were "too disconnected in time and character to permit an inference that Temples believed in Campbell's authority to sell BHDC notes." Opp at 18. The trial court could not properly make such a determination on summary judgment.

Brief at 17-18. Wheeler began to deal with the Marquezes and then walked them across the hall, introduced them to Campbell to invest in BHDC, and told them it was such a good investment he'd invest as well if he had the money. *Id.* at 18-19; *see also* [TR4508, lines 2-17]. This evidence constitutes HTK's manifestations of authority to the Marquezes. *See* Restatement (Second) Agency § 8, cmt (b).

HTK argues Mrs. Marquez also "recanted" her testimony that Wheeler and Campbell told her they were HTK representatives. *Opp* at 20. Again, the record does not support HTK. Mrs. Marquez, on page 38 of her deposition, testified Wheeler told her he was an HTK representative when he first prepared their investment portfolio. [TR4497, lines 13-17] HTK's claim that Mrs. Marquez recanted this testimony is circularly supported only by its own summary judgment brief. *Opp* at 20. Yet, looking at HTK's citations, Wheeler is never mentioned – making it impossible for Mrs. Marquez to have recanted her testimony regarding his representations. The questioning does involve Campbell's representations, wherein, rather than recanting, Mrs. Marquez testified on page 188 she assumed HTK was involved in BHDC:

Q: So your assumptions that Hornor, Townsend & Kent are [sic] involved are based on your understanding that Five Star Financial Group equals Hornor, Townsend & Kent?

A: Yeah. You have all these agents selling this stuff out of their office. What else are you supposed to think?

[TR3266, lines 19-25] A jury could agree with Mrs. Marquez. Thus, there was no proper basis for the trial court to dismiss the Marquezes' claim on summary judgment.

Hunter: HTK argues Hunter's reliance on Five Star cannot be "conflated" with reliance on HTK because Campbell and Five Star were one and the same. Opp at 24-25. Following this logic, when HTK terminated Campbell without telling its customers but left Five Star in place with continued authority to solicit and effect securities transactions (through agents Wheeler, Davis and Alger), it continued to manifest Campbell's apparent authority as well. Utah law requires reliance only on the appearance of authority, not on any particular principal. *Jackson v. Richter*, 891 P.2d 1387, 1392 (Utah 1995)(finding "there must be reasonable reliance on that appearance of authority on the part of the injured party.") The reasonableness of Mrs. Hunter's reliance on Five Star's appearance of authority is for the jury.<sup>3</sup>

Jordan: HTK argues Jordan recanted his testimony as well. He did not. Mr. Jordan, on page 35 of his deposition, testified Campbell gave him his HTK business card at their first meeting. [TR 2818] When they later met at Campbell's office and discussed his affiliations, Mr. Jordan could not recall if they specifically discussed HTK, but he assumed Campbell's affiliation was with the same company on the card. Id. Rather than recant, Mr. Jordan repeated his testimony on page 44 of his deposition:

Q: So the only communication you ever had regarding Hornor, Townsend & Kent is that Mr. Campbell handed you in January of 2003 a business card that had the name Hornor, Townsend & Kent on the bottom?

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<sup>3</sup> HTK also argues Mrs. Hunter's block transfer to HTK did not make her a customer. This is false. HTK assigned her "customer" number HT00253576 and collected commissions on her investments. [TR4766-72]

A: That and, you know, like with the certification thing I asked him about. This is his affiliate with – you know, who he’s selling securities and stuff through.

[TR 2826, lines 13-21] Mr. Jordan assumed Campbell’s certification came through HTK because that was the company listed on his business card for the sale of securities. Any question of the reasonableness of Mr. Jordan’s assumption is a question for the jury.

**Appellants were Entitled to Continue their Belief in Five Star’s Authority**

Here, because each appellant began their relationship with HTK through the authorized actions of an authorized representative, each appellant was *entitled* to continue to believe Campbell was an authorized agent of HTK. Under Utah law, “[t]here is no controversy, nor can there be, as to the general rule of law that one who has dealt with an agent in a matter within the agent’s authority has the right to assume, if not otherwise informed, that such authority continues.” *Montana Reservoir & Irrigation Co. v. Utah Junk Co.*, 228 P. 201 (Utah 1924).

HTK discounts *Johnson v. Nationwide Gen. Ins. Co.*, 971 F.Supp. 725 (N.D.N.Y. 1997), but there the court held Nationwide liable for the acts of a terminated agent who later purported to invest a relative in a Nationwide mutual fund, but really just pocketed the money. The court explained, “when one has constituted and accredited another his agent to carry on a business, the authority of the agent to bind his principal continues even after the actual revocation, until notice of the revocation is given.” *Id.* at 731. Thus, “if the principal does not take appropriate, affirmative steps to destroy the former agent’s apparent authority

and reasonable action to inform third parties, the principal may be held liable for an apparent agent's actions.” *Id.*

Accordingly, Five Star and Campbell's agency continued for appellants “until notice of the revocation [was] brought home to them.” *Id.* This never occurred. HTK argues, “[a]bsent a link between the authority, its source, and the third party claiming apparent authority, it is just as probable that Campbell acted as an independent person.” Opp at 15. Appellants agree – and the opposite is equally true. Where, as here, there *was* a link between the authority (to solicit and effect securities transactions), its source (HTK), and the third parties (HTK's customers), it was probable to appellants Campbell would not be acting alone in recommending promissory note investments.

Indeed, the scam is based on that very inference, leading the NASD to explain BHDC's promissory note scam is predicated on a customers' reliance on his or her registered representative. In the absence of HTK providing notice to its customers, appellants had no idea that Campbell had resigned from HTK, that HTK had not authorized the BHDC investments, and that only certain Five Star representatives were sanctioned and supported by HTK.

### **C. Appellants Relied on the Appearance of Authority**

For this final element, HTK argues only that appellants could not rely on authority which did not exist. Yet, in *Horrocks v. Westfalia Systemat*, 892 P.2d 14 (Utah App. 1995), plaintiff recovered against Westfalia when it's authorized agent sold a milking machine to

plaintiff but pocketed the money and disappeared without ever delivering the machine. According to HTK, this result is incorrect because the plaintiff could never have reasonably relied on the non-existent authority to steal his money. But that is not the law. Rather, “[t]he loss that results from [agent’s] misconduct must be borne by the party who empowered [agent] to commit the wrong . . . Westfalia placed [agent] in the position to perpetrate a fraud. Consequently, Westfalia must bear the responsibility for [agent’s] misconduct.” *Id.* at 16. Appellants produced sufficient admissible evidence they relied on Campbell and Five Star’s apparent authority and would not have invested had they ever been told Campbell was terminated or BHDC was unauthorized.

Additionally, on reconsideration, appellants submitted Declarations to specifically address the trial court’s ruling that appellants had to show reliance on the principal, instead of on the appearance of authority. HTK argues the trial court properly rejected the Declarations as untimely. Opp at 25. However, Utah R. Civ. P. 54(b) sets no time limit on motions for reconsideration, stating only the trial court can reconsider a previous ruling “at any time before the entry of judgment adjudicating all the claims and the rights and liabilities of all the parties.” Once the trial court exercised its discretion to reconsider its prior ruling, there was no basis to reject the Declarations as untimely.

#### **D. Appellants Preserved Evidentiary Issues for Appeal**

HTK argues appellants did not appeal the trial court’s exclusion of their Declarations (and argues the same regarding exclusion of NASD Notice 01-79). Opp at 25, 30, 33 and 41.

In briefing this appeal, appellants did not believe they were required to separately set forth evidentiary rulings encompassed within the principal issues. In researching HTK's argument, appellants still believe they properly raised these evidentiary issues. "To preserve an issue for appellate review, a party must first raise the issue in the trial court." *O'Dea v. Olea*, 2009 UT 46, ¶ 18; 217 P.3d 704. The Declarations were argued below on HTK's Motion to Strike. [TR5621, 5812 and 5865] HTK makes no argument for lack of preservation. Appellants appealed the trial court's order excluding the evidence in their notice of appeal as required by Utah R. App. P. 3.

Beyond that, appellants were required to provide "meaningful analysis or citation to authority . . . to prevent the resulting unfairness to the respondent if an argument or issue was first raised in the reply brief and the respondent had no opportunity to respond." *Maak v. IHC Health Services, Inc.*, 2007 UT App 244, ¶¶ 30-31; 166 P.3d 631. Here, appellants dealt with the court's exclusion of their Declarations on pages 7-8 of their initial brief with analysis of the law regarding reconsideration, citation to the record, and the proper standard of review. HTK can claim no unfairness.

As for NASD Notice 01-79, HTK initially argued below the Notice was irrelevant. [TR5636] Only at oral argument on reconsideration did HTK first claim the Notice had not been produced during the summary judgment briefing. [TR6149, lines 8-15] The trial court mistakenly believed HTK and granted its motion to strike the Notice. [TR5899]

Appellants' first opportunity to address HTK's misrepresentation to the trial court was

on this appeal. Thus, in their Initial brief, appellants explained the issue, set forth the standard of review, and cited to five different places in the record where, contrary to HTK's representation, the Notice was presented during the summary judgment briefing. See Initial Brief at 28-29, fn. 12. The Notice, therefore, is properly before this Court.

**E. Appellants Did Not Have a Duty to Inquire**

HTK lastly argues appellants had a duty to inquire regarding Campbell's authority. Opp at 16. The duty of inquiry applies only in instances where the third party deals "exclusively with the agent." *Workers' Comp. Fund v. Wadman Corp.*, 2009 UT 18, ¶ 12; 210 P.3d 277. For example, in *Wadman*, there was no evidence the principal, Argonaut, "contributed to the formation of a belief that Wadman was Argonaut's agent or that Argonaut knowingly permitted Wadman to assume the exercise of such authority." *Id.* at ¶ 11. Because the principal did nothing to manifest any authority, the third party dealt "exclusively" with the agent and had a duty to inquire.

The opposite is true in this case. Here, each appellant initially dealt with HTK through its registered representatives and, indeed, there is no other way to deal with a corporate principal than through its authorized agents. HTK authorized the Five Star agents to act on its behalf and manifested that authority through authorized representations, employment, licensing, advertising and transacting business. Thus it was not appellants' duty to inquire, but rather HTK's duty to give notice. *Montana Reservoir*, 228 P. at 202; see also *Farrington v. Granite State Fire Ins. Co.*, 232 P.2d 754, 757 (Utah 1951) (finding insured had

no continuing duty to inquire about the actual authority of his insurance agent); *Horrocks*, 892 P.2d at 16 (finding principal authorized agent to make sales to third parties and never gave plaintiff notice of limitation or termination of agent's authority); *Posner v. Equity Title Ins. Agency*, 2009 UT App 347, ¶ 18; 222 P.3d 775 (finding principal authorized agent to close real estate transaction and never notified third party of any limitation or termination of that authority).

As stated by the United States Supreme Court, underlying apparent authority is "business expediency - the desire that third persons should be given reasonable protection in dealing with agents." *American Soc. of Mechanical Eng's, Inc. v. Hydrolevel Corp.*, 456 U.S. 556, 567 (1982), *quoting* Restatement (Second) Agency § 262 cmt.(a). Commerce would grind to a halt if we had to verify an agent's authority before every transaction. Thus, "it is for the ultimate interest of persons employing agents, as well as for the benefit of the public, that persons dealing with agents should be able to rely upon apparently true statements by agents who are purporting to act and are apparently acting in the interests of the principal." *Id.* Here, appellants had no continuing duty of inquiry because HTK itself manifested Five Star's authority.

## **II. THE TRIAL COURT ERRED IN RULING A BROKER-DEALER OWES NO DUTY TO ITS CUSTOMERS FOLLOWING TERMINATION OF ITS AGENT**

HTK owed appellants a duty of care to properly supervise its business and agents. These duty was not disputed, but the trial court ruled such duty did not exist after termination

of an agent. The trial court erred in this ruling.

**A. Appellants Have Consistently Claimed HTK Owed Duties of Care as a Broker-Dealer**

HTK concedes the trial court stated no valid basis for the dismissal of appellants' negligence claim by raising only arguments not relied upon by the trial court below. For example, HTK first asserts appellants' negligent supervision claim did not include any duties of care to appellants and argues a negligence claim is prohibited as "new." Opp at 34. This cannot be a basis for upholding the trial court because there is no substantive distinction between a claim for "negligent supervision" and a claim for "negligence."

"[T]he securities laws . . . impose a duty on broker-dealers to supervise their registered representatives." *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1573 (9<sup>th</sup> Cir. 1990). HTK's duty in this case boils down as well to a duty to supervise. HTK argues it had no duty to supervise non-approved products, disclose BHDC was an investment scam, or inform customers of an agent's termination. Opp at 39, 41. Duty in this context, however, is addressed at "a categorical level." *Jeffs v. West*, 2012 UT 11, ¶ 23. As set forth in *Jeffs*, a duty of due care typically arises from affirmative conduct – here, HTK's recruiting, hiring, training, licensing, and supervising of Five Star and its termination of Campbell. *Id.* at ¶ 6. "As a general rule we all have a duty to exercise care when engaging in affirmative conduct that creates a risk of [ ] harm to others. *Id.* at ¶ 21. HTK owed a duty to appellants to perform the above actions with due care.

Appellants styled their claim "Negligent Supervision." It included allegations HTK

owed appellants a duty of disclosure [TR0808, ¶156] and due care regarding investments [TR0810, ¶ 170]; and appellants would not have invested in BHDC if fully informed. [TR0808, ¶ 154] Appellants alleged HTK breached its duties to them by selling unregistered securities, misleading them, negligently misrepresenting BHDC, and selling securities unsuitable to appellants' investment objectives. [TR0810, ¶¶ 171-174] These allegations were all incorporated by reference into appellants' negligent supervision claim. [TR0813, ¶ 190]

Under Utah law, “[i]n characterizing a cause of action, Utah courts look to the nature of the action and not the pleading labels chosen.” *Failor v. MegaDyne Med. Prods., Inc.*, 2009 UT App 179, ¶ 12; 213 P.3d 899. Here, the nature of appellants' claim was set forth in the complaint regardless of whether it was styled negligent supervision or negligence. Indeed, appellants' complaint must be viewed “with great liberality in sustaining the sufficiency of allegations stating a cause of action.” *Williams v. State Farm Ins. Co.*, 656 P.2d 966, 971 (Utah 1982). Thus, “[e]ven if a complaint is vague, inartfully drafted, a bare-bones outline, or not a model of specificity, the complaint may still be adequate so long as it can reasonably be read as supporting a claim for relief, giving the defendant notice of that claim.” *Casaday v. Allstate Ins. Co.*, 2010 UT App 82, ¶12; 232 P.3d 1075.

HTK cited no authority for its argument that claims for negligent supervision and negligence are different in scope or substance. *See contra Jackson*, 891 P.2d at 1392 (analyzing negligent supervision claim as basic negligence claim); *cf. Savage v. Utah Youth*

*Village*, 204 UT 102, ¶ 13; 104 P.3d 1242 (finding “negligent placement” claim simply implicates “negligence principles.”) The purpose of the claim is not to allege some distinct form of negligence, but rather to allege direct liability against a principal for its own negligence as opposed to *respondeat superior* liability for the acts of its agents. “Even when the doctrine of respondeat superior is inapplicable, an employer may be liable for its negligence in the hiring or supervision of an employee.” *Birkner v. Salt Lake Co.*, 771 P.2d 1053, 1059 (Utah 1989). Accordingly, appellants properly stated a claim for negligent supervision against HTK.

**B. HTK also Owed Duties to Appellants as Customers**

Appellants were very clear before the trial court that their negligent supervision claim was not limited to HTK’s supervision of Campbell. Appellants stated, “HTK had an affirmative duty to supervise its Five Star office and customers. This duty included the duty to inform customers of any limits on agent authority and termination of that authority. HTK’s duty to supervise also included distinguishing between authorized and unauthorized agents and products.” [TR4228] Counsel tried to make this clear at oral argument when the trial court asked about any distinction between appellants’ negligent supervision claim and a negligence claim:

Counsel: I think the only distinction that we would draw is, this is not vicarious liability for Hornor, Townsend and Kent. They are primarily liable on the negligence claim, whether you want to call it negligence, negligent supervision, whatever. This is their primary claim.

Court: But how can they do that when there’s no direct relationship? In other

words, don't they have to be in a position where they can supervise Campbell at the time of the incident? Of the sale? If Campbell has quit, how can they supervise him?

Counsel: . . . They still have to supervise their own customers, Your Honor. They still have to supervise Five Star Financial. They haven't taken that down. I can't just say, Campbell has left, therefore I've washed my hands of the entire business. I still have customers. HTK customers that I need to supervise. I still have Five Star Financial out there that I need to supervise .

.. You have a duty to inform your customers, at a minimum, a duty to inform those customers that this agent is no longer authorized . . . That's the duty that Hornor Townsend and Kent had, and that doesn't happen. And it's a question of fact whether or not they breached that duty or not. Did they exercise the utmost vigilance to see that that did not occur? Did they adequately supervise their customers? Did they adequately supervise their registered representatives? Did they take steps to destroy the authority of Jeff Campbell and Five Star Financial? . . . That's why there's a negligence claim directly against Hornor Townsend and Kent. For their failure – not for – not vicarious liability arising out of Campbell's actions, for Hornor Townsend and Kent's own failures in supervising these customers and in supervising their agents.

[TR6053-56] This Court recently recognized that the customer relationship may indeed impose a duty of protection from harm. *Jeffs*, 2012 UT 11 at ¶ 10, fn.7. HTK further acknowledged in its compliance manual it owed duties to its customers “to ensure the [sic] that the clients' welfare is served and protected.” [TR6766-555]

The trial court made no finding regarding who was a customer. HTK argues only persons who purchase broker-approved products are customers. Opp at 39-40. This narrow definition is not supported in the caselaw. For example, the court in *Lehman Bros., Inc. v. Certified Reporting Co.*, 939 F.Supp. 1333, 1339 (N.D.Ill. 1996) rejected any actual purchase requirement because, “Lehman is involved in more than simply selling stock. It is in the

business of making investment recommendations, soliciting customers, and supervising its employees.” The *Lehman* court recognized, “the ordinary use of the word ‘customer’ contemplates, for example, the person who spends time browsing in a department store, but decides not to buy.” *Id.*

In the context of who may demand NASD arbitration in a securities claim, the term “customer” is construed broadly such that, “when an investor deals with a member’s [i.e. broker-dealer] agent or representative, the investor deals with the member.” *Lincoln Fin. Advisors Corp. v. Healthright Partners, LP*, 2010 WL 322141 (D.Utah 2010). The same holds in civil litigation. In *Prymak v. Contemporary Fin. Solutions, Inc.*, the court ruled those plaintiffs who dealt with the registered representative prior to his termination were clients of the broker-dealer as well. 2007 WL 4250020, 12 (D.Colo. 2007). There, the registered representative approached the plaintiffs and offered his services as a stockbroker, financial planner and insurance specialist. *Id.* at 13. The plaintiffs never opened an account with the broker-dealer and never purchased an authorized product, but their dealings with the representative were sufficient to qualify them as customers of the broker-dealer. Likewise, in *Dolin v. Contemporary Fin. Solutions, Inc.*, the court found plaintiffs were customers of the broker-dealer based on their dealings with the registered representative whether or not they had opened a formal account. 622 F.Supp. 2d 1077, 1083 (D.Colo. 2009).

Here, appellants Burdick, Temples and Manus opened HTK accounts. Appellants Hunter, Henrie and Swinburne were block transferred to HTK which then assigned them

HTK customer numbers and collected their investment commissions. Appellants Marquez and Jordan did not open accounts, but they met with HTK representatives Wheeler and Campbell to discuss investment strategies and receive investment advice. Therefore, all appellants were customers of HTK and were owed general duties of care.

**C. HTK's Duties did not End with Campbell's Termination**

The only basis the trial court ever stated for rejecting HTK's duty of care was, "[b]ecause Mr. Campbell was not a registered representative of HTK at the time he sold BHDC, HTK owed no duty to supervise Mr. Campbell as its alleged representative." [TR5018, ¶87] Since brokers owe a duty to exercise due care in undertaking affirmative actions or in protecting customers, the question is whether other factors justify eliminating such duty upon the termination of an agent. *Jeffs*, 2012 UT 11 at ¶ 19.

For example, HTK knew its customers were dealing with Campbell and, thus, had "reason to know that the third person is likely to continue to deal with the agent until he has information as to facts indicating that the agent's authority has terminated or otherwise has notice of the termination." Restatement (Second) of Agency, § 129, comment (a). By failing to notify anyone of Campbell's termination or changes at Five Star, HTK knew appellants would continue to invest, including in Campbell's new promissory note scam. HTK's own "Compliance Corner" laid out the massive investor losses already incurred by this scam (over \$300 million by the year 2000). [TR4807] Here, Campbell's termination only increased the foreseeability and likelihood of injury.

Further, broker-dealers and unsophisticated investors are not on equal footing in the financial services industry. Markets, investment products, and risk management are in almost every case better understood by the broker than the customer. Indeed, the broker holds itself out to the unsophisticated investor as a guide through treacherous waters. Thus, the securities industry recognizes the best protection for investors is requiring brokers to exercise due care to recruit, license, train, and supervise their offices and agents and bear the loss when they breach that duty. *See* [TR6766-658-661] (outlining broker-dealers' supervisory responsibilities for remote branch offices like Five Star).

A duty of full and fair disclosure allows investors to make informed decisions. A duty of professionalism requires the broker to vigilantly supervise its business, representatives and customers for potential wrongdoing. A duty of suitability ensures investments are consistent with the customers goals and risk tolerances. These duties only took on heightened importance once HTK terminated Campbell knowing he was headed off to try sell its customers unregistered securities without a license.<sup>4</sup> Accordingly, appellants stated a claim for negligent supervision which must go to a jury.

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<sup>4</sup> Affinity fraud like that involved in this case is a problem of epidemic proportions in Utah. The Utah Department of Commerce issued a Media Alert on January 3, 2011 finding Affinity Fraud was once again the top investment scam. The specific promissory note scheme used in this case came in at No. 5. The Deseret News reported in 2010 that the FBI in Utah was investigating 115 cases of investment fraud with 4,400 victims and losses of \$1.4 billion. The State of Utah, the Division of Securities, the Utah Securities Fraud Task Force, and federal agencies are all working to "keep Utahns from falling in the trap of Ponzi schemes or other frauds perpetrated by people they trust." Deseret News, Utah Steps Up Fraud Awareness Efforts, June 4, 2010, Joseph Dougherty.

### III. APPELLANTS HAVE A CLAIM FOR MATERIAL AID LIABILITY

Appellants Marquez and Temples have a claim against HTK based on the direct aid and involvement of HTK agent Wheeler in their BHDC investments. HTK claims Wheeler was “exonerated” of all wrongdoing and thus “Wheeler’s conduct cannot serve as the basis for HTK’s liability.” Opp at 33. First, Wheeler was never “exonerated,” and, second, his conduct is not scrubbed from the record even if he was. Appellants acquiesced to Wheeler’s summary judgment because he was not a “seller” (i.e. one who actually passes title to the stock or who actively solicits the purchase motivated by a desire to serve his own financial interests). Yet, Wheeler’s participation in BHDC can be other than as a “seller,” including referring investors to the seller, introducing investors to the seller, and/or arranging meetings with the seller.<sup>5</sup> Wheeler was never “exonerated” of this conduct and HTK remains liable for Wheeler as his principal.

HTK also argues appellants asserted a material aid claim only for Marquez and Temples, but as set forth on page 38 of appellants’ brief, appellants Burdick, Hunter and Jordan also have a claim against HTK for material aid as described in Restatement (Second) of Agency sections 261 and 262 wherein the principal incurs liability because it “puts a

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<sup>5</sup> HTK argues Wheeler’s involvement was “too minimal to impose liability.” Opp at 33. Yet, the NASD warned HTK (and HTK warned its agents): “Associated persons are reminded that ‘participation’ in a securities transaction includes not only making the sale, but *referring customers, introducing customers* to the issuer, *arranging and/or participating in meeting* between customers and the issuer, or receiving a referral or finder’s fee from the issuer.” [TR6766-689].

servant or other agent in a position which enables the agent while apparently acting within his authority to commit a fraud upon third persons.” Thus, these plaintiffs have claims against HTK based on Five Star and Campbell’s apparent authority traceable to HTK.

#### **IV. APPELLANTS STATED A CLAIM FOR CONTROL PERSON LIABILITY**

HTK argues appellants’ control person evidence was untimely but sets forth no deadline that was missed or any prejudice actually suffered. Opp at 30. Appellants still maintain there is no prejudice to a party posed by an accurate record.

HTK further argues it is not liable as a control person because it did not control the sale of BHDC notes. Opp at 32. HTK is a control person, however, simply by virtue of being Campbell’s broker-dealer, regardless of its actual participation in the scheme. The leading case is *Hollinger v. Titan Capital Corp.*, wherein the Ninth Circuit ruled, “for appellants to establish that Titan was a controlling person, they need only show that Wilkowski was not himself a registered broker-dealer but was a representative employed by or associated with a registered broker-dealer . . . Accordingly, Titan was, as a matter of law, a ‘controlling person’ under §20(a) with respect to Wilkowski.” 914 F.2d 1564, 1574 (9<sup>th</sup> Cir. 1990). Thus, “a plaintiff is *not* required to show ‘culpable participation’ to establish that a broker-dealer was a controlling person under § 20(a).” *Id.* at 1575 (emphasis in original).

HTK cites *Wenneman v. Brown*, 49 F.Supp. 2d 1283 (D.Utah 1999), wherein the court ruled outside legal counsel did not sufficiently control a client’s securities offerings to impose §20 liability. Opp at 32. Here, however, HTK was not Campbell’s outside legal

counsel, but rather his broker-dealer charged with licensing and supervising his activities. As the SEC explained in *Hollinger*, “the representative/broker-dealer relationship is necessarily one of controlled and controlling person because the broker-dealer is required to supervise its representatives.” *Id.* at 1573. In the case of a broker-dealer, no further participation is necessary.

Utah’s statute provides a broker-dealer with the defense to prove it did not, and in the exercise of reasonable care, could not know of the unauthorized activities. *See* Utah Code Ann. § 61-2-22(4)(a). This defense is not available to HTK because it knew of Campbell’s intended scheme. HTK thus argues holding a principal liable for the unauthorized acts of its agent during the 30 day waiting period would be absurd. *Opp* at 32. But Utah law is clear HTK remained responsible for Campbell until it destroyed his authority. That could not be done until the 30 day period expired. That HTK never did it at all is the only absurdity here.

## **V. APPELLANTS ARE ENTITLED TO A PROPER DETERMINATION OF REASONABLE ATTORNEYS FEES**

The purpose of Utah’s fee-shifting statute was to make appellants whole. It is undisputed appellants owed their attorneys one-third of any recovery under their contingent fee agreement. Thus, in its purest form, the fee-shifting statute would shift the burden of the contingent fee to Mr. Campbell. The question for the trial court was whether the amount of the contingent fee was a reasonable award. The court abused its discretion by failing to exercise its discretion to answer this question.

HTK argues Utah adopted the “lodestar” method to assess attorneys’ fees in *Barker*

*v. Utah Public Serv. Comm'n*, 970 P.2d 702 (Utah 1998). Opp at 46. This Court used the lodestar method in *Barker* because the Public Service Commission had, but it did not adopt the lodestar method for other cases and has not used it since. *Id.* at 708.

HTK also argues the trial court properly performed a lodestar analysis to reject appellants' fee request. This argument is belied by the fact that, under the lodestar method, the court would have had to at least award fees for appellants' prosecution of claims after HTK was out of the case. Those 282 hours were detailed in appellants' declaration and the reasonable fee was undisputed. [TR5803-11] Thus, if the trial court had used the lodestar method it would have had to award at least \$84,600 in fees.

But the trial court did not use the lodestar or any other method. It simply rejected a contingent fee as the starting point for reasonableness. Yet, "[t]he reasonableness of an award of attorney fees is highly individualized and decided according to the factually varied context of each particular case." *Amyx v. Columbia House Holdings, Inc.*, 2005 UT App 118, ¶ 6; 110 P.3d 176. The proper starting point in a contingent fee case is the contingent fee. The court can certainly raise or lower that fee depending on the reasonableness factors of Utah R. Civ. P. 73, but the trial court refused to undertake any such analysis. By refusing to employ its discretion, the trial court abused its discretion.

## **VI. APPELLANT HOWELL'S RELEASE IS LIMITED TO CLAIMS ARISING OUT OF HIS INSURANCE POLICY**

HTK argues it was released under an agreement between appellant Howell and his insurance company. Opp at 43. In *CoBon Energy, LLC v. AGTC, Inc.*, the Utah Court of

Appeals construed a similar release also under Pennsylvania law and ruled the trial court erred in expanding the scope of the release beyond the intent of the parties. 2011 UT App 330; 264 P.3d 219. As here, the parties in *CoBon* had two separate bases for claims, a 1996 contract and a 1998 contract. The parties settled a lawsuit concerning the 1998 contract and signed a release which the defendant argued covered all claims, including claims which would later arise under the 1996 agreement. The trial court agreed and granted summary judgment.

The Court of Appeals reversed, beginning from the premise, “[t]he courts of Pennsylvania have traditionally determined the effect of a release using the ordinary meaning of its language and interpreted the release as covering only such matters as can fairly be said to have been within the contemplation of the parties when the release was given.” *Id.* at ¶ 17. The release began by specifically referencing the parties to the 1998 contract and claims arising therefrom which did not include CoBon Energy. *Id.* at ¶ 18. However, CoBon Energy was included in the broad list of released parties. *Id.* at ¶ 19. The Court ruled the limited language as to the claims being released should not be expanded by the general language of the released parties, quoting, “[w]hen interpreting contract language, specific provisions ordinarily will be regarded as qualifying the meaning of broad general terms in relation to a particular subject.” *Id.* at ¶ 22.

Here, the Howell release specifically limited its scope: “The parties to the Agreement desire to settle and compromise all disputes and claims between them arising from the sale

of Penn Mutual Policy Number 8129818 ('the policy') by Jeffrey Campbell to Mr. Grant Howell." [TR1257] The release further specifically excluded claims against Campbell and specifically pegged the consideration to the cash surrender value of the policy. *Id.* HTK argues all this language is nullified by the release's broad scope of the parties being released.

The *CoBon* court ruled, however, "[u]nder Pennsylvania law, we would have to strictly construe any such broad, prospective language to ensure that the scope of the Release did not exceed the parties' intent. We find no warrant in Pennsylvania law for expanding the scope of the literal language of a release to embrace claims outside its ordinary meaning." *Id.* at ¶ 38. Likewise, the Howell release should not be construed to cover claims arising out of transactions never contemplated by the plain language of the agreement. Therefore, appellant Howell's claims must go to a jury.

## VII. APPELLANTS DID NOT WAIVE OTHER CLAIMS

HTK argues all claims not litigated against Campbell were dismissed on the merits, "exonerating" Campbell, under *State v. Madsen*, 2008 UT App 415. Opp at 27. The *Madsen* case, however, only applies to an entire suit dismissed under Utah R. Civ. P. 41. Here, appellants did not dismiss their action against Campbell, but rather chose to pursue just one claim to judgment.

The Ninth Circuit best distinguished our case from *Madsen* finding, "[n]either res judicata nor collateral estoppel applies in an action where plaintiff dismisses one claim of a multi-count complaint and proceeds on another. Defendants' argument is premised on the

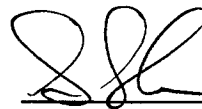
assumption that plaintiff's dismissal of his third count may be given the effect of a dismissal with prejudice under Federal Rule of Civil Procedure 41(a). Rule 41(a) provides that 'an action' may be dismissed. Because no action was dismissed here but only one of several claims asserted, the rule does not apply." *Newman v. Bayliner Marine Corp.* 1998 WL 911866, 1 (9<sup>th</sup> Cir. 1998). Thus, there has never been any release or discharge of Campbell and Utah Code Ann. § 15-4-4 does not apply.

### CONCLUSION

Appellants request remand of their claims for trial by jury.

DATED this 9<sup>th</sup> day of March, 2012.

SILVESTER & CONROY, L.C.



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**CERTIFICATE OF SERVICE**

I hereby certify that on the 12<sup>th</sup> day of March, 2012, I caused to be mailed via U.S. Mail, postage prepaid, a true and correct copy of the foregoing REPLY BRIEF OF APPELLANTS to the following:

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