

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

CHARLES EVANS PATTERSON,

Plaintiff,

v.

E*TRADE CLEARING, LLC,

Defendant.

Case No. 16-cv-03388-DMR

ORDER ON DEFENDANT'S MOTION TO DISMISS

Re: Dkt. No. 8

Defendant E*TRADE Clearing ("ETC") moves pursuant to Federal Rule of Civil Procedure 12(b)(6) to dismiss two of Plaintiff Charles Evans Patterson's five claims for relief in his first amended complaint ("FAC"). [Docket No. 8.] Having considered the parties' submissions and oral argument, the court grants Defendant's motion.

I. BACKGROUND

Plaintiff makes the following allegations in the FAC.[1] Plaintiff has been an ETC account holder for many years. He opened his most recent futures account with ETC in 2014 ("the account"). Prior to opening the account, Plaintiff told ETC representative Andrew Valcik about a previous loss of funds that had occurred when a broker liquidated Plaintiff's futures position to cover margin requirements without first giving him an opportunity to deposit funds to cover the deficiency. Plaintiff sought Valcik's confirmation that ETC would notify Plaintiff in the event that "such a situation were ever to occur in a futures account maintained with [ETC]." FAC ¶ 8. Plaintiff alleges that Valcik "unequivocally confirmed that [ETC] would provide such notice, and an opportunity to deposit funds to satisfy margin requirements, prior to ever liquidating one of

[1] When reviewing a motion to dismiss for failure to state a claim, the court must "accept as true all of the factual allegations contained in the complaint." Erickson v. Pardus, 551 U.S. 89, 94 (2007) (per curiam) (citation omitted).

United States District Court
Northern District of California

Plaintiff's positions." Id. The Futures Account Agreement covering the account contains the following provision:

> Market conditions permitting, E*TRADE Clearing agrees to make reasonable efforts to notify Customer of any margin call or deficiency and allow Customer a reasonable period of time to cure any margin deficiency.

FAC Ex. A (Futures Account Agreement (the "Agreement")) at § 7(b)(i)). Based on Valcik's assurances, and what Plaintiff describes as the "plain language" of the contract, Plaintiff entered into the Agreement and opened the account at some point in 2014.

At some time on February 11, 2016, ETC liquidated the sole position in the account to cover a margin deficiency, causing Plaintiff to lose over $400,000 in equity. Plaintiff alleges that prior to the liquidation, ETC never contacted Plaintiff to request additional funds to cover the margin requirements. According to Plaintiff, as of 1:35 am PST on February 11, 2016, the equity in Plaintiff's account exceeded ETC's margin requirements. Plaintiff received an email from one of ETC's Risk Analysts on February 11, 2016 at 1:38 am PST stating only, "Please call the Futures desk at [number]." FAC ¶ 15. Plaintiff alleges that the email gave him no reason to believe that ETC planned to liquidate the position in the account and did not otherwise notify him that additional funds were required. Id. According to Plaintiff, ETC feasibly could have notified him of any deficiency in his account, given the market conditions.

Plaintiff filed a complaint in Contra Costa County Superior Court on May 12, 2016, and filed the FAC on May 17, 2016. Defendant removed the action to federal court on June 17, 2016. Plaintiff brings five claims for relief: 1) breach of the Futures Account Agreement; 2) breach of the implied covenant of good faith and fair dealing; 3) breach of fiduciary duty; 4) negligence; and 5) violation of California Business and Professions Code § 17200. ETC now moves to dismiss Plaintiff's second and third claims for breach of the implied covenant of good faith and fair dealing, and for breach of fiduciary duty.

II. LEGAL STANDARD

A motion to dismiss under Rule 12(b)(6) tests the legal sufficiency of the claims alleged in the complaint. See Parks Sch. of Bus., Inc. v. Symington, 51 F.3d 1480, 1484 (9th Cir. 1995).

When reviewing a motion to dismiss for failure to state a claim, the court must "accept as true all of the factual allegations contained in the complaint," Erickson v. Pardus, 551 U.S. 89, 94 (2007) (per curiam) (citation omitted), and may dismiss a claim "only where there is no cognizable legal theory" or there is an absence of "sufficient factual matter to state a facially plausible claim to relief." Shroyer v. New Cingular Wireless Servs., Inc., 622 F.3d 1035, 1041 (9th Cir. 2010) (citing Ashcroft v. Iqbal, 556 U.S. 662, 677-78 (2009); Navarro v. Block, 250 F.3d 729, 732 (9th Cir. 2001)) (quotation marks omitted). A claim has facial plausibility when a plaintiff "pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." Iqbal, 556 U.S. at 678 (citation omitted). In other words, the facts alleged must demonstrate "more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." Bell Atl. Corp. v. Twombly, 550 U.S. 554, 555 (2007) (citing Papasan v. Allain, 478 U.S. 265, 286 (1986)); see Lee v. City of L.A., 250 F.3d 668, 679 (9th Cir. 2001), overruled on other grounds by Galbraith v. Cty. of Santa Clara, 307 F.3d 1119 (9th Cir. 2002).

As a general rule, a court may not consider "any material beyond the pleadings" when ruling on a Rule 12(b)(6) motion. Lee, 250 F.3d at 688 (citation and quotation marks omitted). However, "a court may take judicial notice of 'matters of public record,'" id. at 689 (citing Mack v. S. Bay Beer Distrib., 798 F.2d 1279, 1282 (9th Cir. 1986)), and may also consider "documents whose contents are alleged in a complaint and whose authenticity no party questions, but which are not physically attached to the pleading," without converting a motion to dismiss under Rule 12(b)(6) into a motion for summary judgment. Branch v. Tunnell, 14 F.3d 449, 454 (9th Cir. 1994), overruled on other grounds by Galbraith, 307 F.3d at 1125-26. The court need not accept as true allegations that contradict facts which may be judicially noticed. See Mullis v. U.S. Bankr. Court, 828 F.2d 1385, 1388 (9th Cir. 1987).

III. DISCUSSION

The Agreement provides that "the rights and liabilities of the parties shall, in all respects, be governed by and construed in accordance with law of the State of New York, without regard to its conflict of law provisions." Agreement § 15(i)(i). The parties concur that New York law governs Plaintiff's claims for purposes of this motion.

A. Breach of Fiduciary Duty

To state a claim for breach of a fiduciary duty under New York law, a plaintiff must allege "(i) the existence of a fiduciary duty; (ii) a knowing breach of that duty; and (iii) damages resulting therefrom." Johnson v. Nextel Commc'ns, Inc., 660 F.3d 131, 138 (2d Cir. 2011). ETC argues that it did not owe a fiduciary duty to Plaintiff because Plaintiff's account was non-discretionary. According to ETC, New York law does not recognize a fiduciary duty between a broker and its client in relation to a non-discretionary commodity trading account.

A non-discretionary account is one "in which the customer rather than the broker determines which purchases and sales to make." Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 461 F. Supp. 951, 952 (E.D. Mich. 1978). "A nondiscretionary customer by definition keeps control over the account and has full responsibility for trading decisions." de Kwiatkowski v. Bear, Stearns & Co., Inc., 306 F.3d 1293, 1302 (2d Cir. 2002); see id. at 1296 (a non-discretionary trading account is "one where all trades require the client's authorization"). Under New York law, "[t]he fiduciary obligation between a broker and customer . . . is limited to affairs entrusted to the broker, and '[t]he scope of affairs entrusted to a broker is generally limited to the completion of a transaction.'" Bissell v. Merrill Lynch & Co., Inc., 937 F. Supp. 237, 246 (S.D.N.Y. 1996) (second alteration in original) (quoting Schenk v. Bear, Stearns & Co., 484 F. Supp. 937, 947 (S.D.N.Y. 1979)). "The broker's duties ordinarily end after each transaction is done," de Kwiatkowski, 306 F.3d at 1302, and "[i]n the absence of discretionary trading authority delegated by the customer to the broker . . . a broker does not owe a general fiduciary duty to his client." Bissell, 937 F. Supp. at 246 (citing Schenk, 484 F. Supp. 937 at 946-47); see also Fekety v. Gruntal & Co., 595 N.Y.S.2d 190, 191 (1993) ("a broker does not, in the ordinary course of business, owe a fiduciary duty to a purchaser of securities"); Celle v. Barclays Bank P.L.C., 851 N.Y.S.2d 500, 501 (2008) ("brokers for non-discretionary accounts do not owe clients a fiduciary duty").

Here, the Agreement was clearly non-discretionary because it vested Plaintiff with full responsibility for making all trading decisions. Specifically, it stated that ETC "is authorized to purchase and sell contracts in Commodity Interests for Customer's account in accordance with Customer's oral, written or electronically transmitted instructions," and that "Customer is fully responsible for making all final decisions as to any transactions for Customer's account." Agreement at § 6(a).

Plaintiff does not dispute that his account was non-discretionary. Instead, he seizes on the concept of discretion. He seems to suggest that if a non-discretionary account carries no fiduciary duty, then the opposite must be true: that the existence of discretion in an account must give rise to a fiduciary duty. Plaintiff thus argues that ETC owed him a fiduciary duty because a particular contract term vested discretion in ETC under certain circumstances. Under the Agreement, in the event of a margin deficiency, ETC "retains, at all times, the right in its sole discretion to liquidate all or part of Customer's positions and/or account through any means available, without prior notice to Customer." Agreement at § 7(b)(ii).[2] According to Plaintiff, this provision conferred specific discretionary authority on ETC, which gave rise to a fiduciary duty.

This is somewhat nonsensical. Plaintiff argues that ETC owed him a fiduciary duty because Section 7(b)(ii) vested ETC with discretion. However, that provision gave ETC virtually absolute discretion to liquidate Plaintiff's positions, without prior notice. Given the breadth of that discretion and authority, it is difficult to understand how ETC could have breached a fiduciary duty by liquidating Plaintiff's holdings without reasonable notice. Plaintiff goes on to argue that ETC breached its fiduciary duty when it liquidated Plaintiff's account without making reasonable efforts to provide Plaintiff with notice of the deficiency and an opportunity to cure, as provided in Section 7(b)(i) of the Agreement, which is discussed above. The court will analyze Plaintiff's argument, despite its contorted nature.

None of the cases cited by the parties specifically address Plaintiff's argument that ETC owed Plaintiff a fiduciary duty based on the liquidation provision in the Agreement. ETC cites Fesseha v. TD Waterhouse Investor Services, Inc., 761 N.Y.S.2d 22, 23 (2003), which involves

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[2] The court may consider the terms of the agreement between the parties without converting the motion to dismiss to a motion for summary judgment since Plaintiff attached the Agreement as an exhibit to the FAC. See Branch, 14 F.3d at 453.

circumstances similar to those alleged here, but is distinguishable. In Fesseha, an investor sued his broker after it liquidated securities in his trading account to satisfy margin deficiencies without giving him notice and an opportunity to cure. Id. The trial court dismissed the investor's breach of fiduciary duty claim on the ground that "a broker does not owe a general fiduciary duty to his client" in the absence of discretionary trading authority. Fesseha v. TD Waterhouse Investor Services, Inc., 747 N.Y.S.2d 676, 682 (2002) (citations omitted). The New York appeals court affirmed the dismissal of the claim, holding that it "was properly dismissed since plaintiff opened a non-discretionary trading account, and the relationship between plaintiff and defendant was merely that of broker and customer." Fesseha, 761 N.Y.S.2d at 24 (citations omitted). However, Fesseha does not help here, because it does not grapple with the question of whether a liquidation provision that vests discretion in a broker gives rise to a fiduciary duty.

Plaintiff relies on Conway v. Icahn & Co., Inc., 16 F.3d 504, 510 (2d Cir. 1994), but it is also distinguishable. In Conway, the plaintiff maintained a non-discretionary margin account with the defendant broker Icahn & Co. ("Icahn"). Icahn cleared its transactions through another broker-dealer, third party Cowen & Co. ("Cowen"). Id. at 505. Plaintiff's agreement with Cowen permitted Cowen to liquidate securities in his margin account in any manner and without prior notice to the plaintiff, id. at 506, but Icahn was not a party to that agreement. Id. at 508-09. After a "precipitous stock market decline," Cowen directed Icahn to liquidate securities in the plaintiff's account to meet Cowen's minimum margin requirements. Id. at 507. Icahn immediately liquidated the plaintiff's securities to cover the deficiency. Id. The plaintiff sued Icahn to recover the losses that he sustained in connection with the sale of his securities. A jury found in the plaintiff's favor on his negligence and breach of fiduciary duty claims. Id. at 508. On appeal, the Second Circuit held that, unlike the plaintiff's agreement with Cowen, the plaintiff's non-discretionary account with Icahn required Plaintiff's authorization for all purchases and sales. Therefore, "absent a waiver of notice running in its favor, Icahn had a duty to notify [the plaintiff] prior to the execution of the sellout and to secure his consent as to the items to be sold." Id. at 510.

Here, by contrast, the Agreement governing the parties' relationship contains a margin deficiency provision specifying that ETC as broker "retains, at all times, the right in its sole discretion to liquidate all or part of Customer's positions and/or account through any means available, without prior notice to Customer." Agreement at § 7(b)(ii). In Conway, there was no such provision in the agreement between the plaintiff and Icahn, the broker who actually liquidated his account. See Conway, 16 F.3d at 509.

Plaintiff also cites Jaksich v. Thomson McKinnon Securities, Inc., 582 F. Supp. 485, 502 (S.D.N.Y. 1984), and Conte v. U.S. Alliance Federal Credit Union, 303 F. Supp. 2d 220, 228 (D. Conn. 2004). Again, both are distinguishable. In Jaksich, the opinion does not state whether the plaintiff held a non-discretionary trading account. However, the facts suggest that the broker had some discretion to make trading decisions, because plaintiff was seeking "investment guidance," as she was "virtually ignorant as to what was happening." See 582 F. Supp. at 488-91. In Conte, the plaintiff entered into a stock-secured loan agreement with his credit union to set up a secured loan revolving credit plan. 303 F. Supp. 2d at 222-23. The court discussed the general rule that a bank does not have a fiduciary duty to its borrowers, but concluded that a factual question remained as to whether the bank had exceeded the usual creditor-debtor relationship based on review of the parties' dealings over thirty years, which included the bank's provision of investment advice, as well as its prior course of conduct. Id. at 228.

Based on the court's own research, it does not appear that any court has ruled on the precise issue raised here, namely whether under New York law, a broker's discretion to liquidate positions in the event of a margin deficiency gives rise to a fiduciary duty even though the account is otherwise non-discretionary. The court therefore turns to the general question of when a fiduciary duty arises in a broker relationship. Courts determining the existence of a fiduciary duty under New York law examine "whether one person has reposed trust or confidence in the integrity and fidelity of another who thereby gains a resulting superiority or influence over the first." *Teachers Ins. & Annuity Ass'n of Am. v. Wometco Enters*., Inc., 833 F. Supp. 344, 349-50 (S.D.N.Y. 1993).

Plaintiff argues that he has satisfied this inquiry at the pleading stage by alleging that he "trusted [ETC] with substantial funds that he deposited into the account" after receiving ETC's assurances regarding notice of and opportunity to cure any margin deficiency prior to liquidation, including the corresponding provision in the parties' agreement (see Agreement at section 7(b)(i)). Opp'n at 6. He argues that these facts show that he "reposed trust or confidence in the integrity and fidelity" of ETC, which gave rise to a fiduciary relationship between the parties. Id. (citing Teachers Ins., 833 F. Supp. at 349). Plaintiff also argues that determining the existence of a fiduciary relationship "requires a fact-specific inquiry," and that resolution of this issue is inappropriate on a motion to dismiss. Id. (citing Roni LLC v. Arfa, 18 N.Y.3d 846, 848 (2011)).

The court finds that Plaintiff has not alleged sufficient facts to support the existence of a fiduciary relationship between the parties. Plaintiff only addresses the first part of the test, which focuses on whether he reposed trust or confidence in ETC's integrity and fidelity. He ignores the second part, which requires that ETC gained a "resulting superiority or influence over" him. The Second Circuit has recognized that in "'special circumstances,' a broker may owe a broader duty to a client than a purely transactional one to prevent the brokers from taking 'unfair advantage of their customers' incapacity or simplicity.'" Ciccone v. Hersh, 530 F. Supp. 2d 574, 578 (S.D.N.Y. 2008) (quoting de Kwiatkowski, 306 F.3d at 1308-09). Such circumstances "that render the client dependent" include "a client who has impaired faculties, or one who has a closer than arms-length relationship with the broker, or one who is so lacking in sophistication that de facto control of the account is deemed to rest in the broker." de Kwiatkowski, 306 F.3d at 1308. Plaintiff does not allege that any of these circumstances are present here. See, e.g., Ciccone, 530 F. Supp. 2d at 579 (holding that the court was "not persuaded that Plaintiffs are the 'naïve and vulnerable client[s]' who are protected by 'special circumstances.'" (quotation omitted)). To the contrary, according to the FAC, Plaintiff is a sophisticated investor who had been an ETC account holder "for many years" and had millions of dollars of equity in his ETC accounts. FAC ¶¶ 7, 11. The FAC is devoid of allegations that suggest that ETC gained "superiority or influence" over Plaintiff as a result of their relationship, giving rise to a fiduciary relationship. See Teachers Ins., 833 F. Supp. at 349; see also Roni LLC, 18 N.Y.3d at 848 ("[a] fiduciary relation exists when confidence is reposed on one side and there is resulting superiority and influence on the other" (quotation omitted)).

Since Plaintiff has failed to allege facts supporting the existence of a fiduciary relationship between Plaintiff and ETC, his breach of fiduciary duty claim is dismissed. Plaintiff is granted leave to amend this claim, provided, however, that the amended claim is not duplicative of his breach of contract claim. See, e.g., Zorbas v. U.S. Trust Co., N.A., 48 F. Supp. 3d 464, 478 (E.D.N.Y. 2014) ("'where there [is] a formal written agreement covering the precise subject matter of the alleged fiduciary duty, there is no actionable tort for a breach of fiduciary duty.'" (quotation omitted)); Pane v. Citibank, N.A., 797 N.Y.S.2d 76, 77 (2005) (holding that the defendant's actions cannot be "deemed a breach of fiduciary duty given a formal written agreement covering the precise subject matter of the alleged fiduciary duty.").

B. Breach of the Implied Covenant of Good Faith and Fair Dealing

ETC next moves to dismiss Plaintiff's claim for breach of the implied covenant of good faith and fair dealing as duplicative of his breach of contract claim. "New York law implies a covenant of good faith and fair dealing, pursuant to which neither party to a contract shall do anything which has the effect of destroying or injuring the right of the other party to receive the fruits of the contract." Thyroff v. Nationwide Mut. Ins. Co., 460 F.3d 400, 407 (2d Cir. 2006) (quotation omitted). "The implied covenant can only impose an obligation consistent with other mutually agreed upon terms in the contract. It does not add [ ] to the contract a substantive provision not included by the parties." Broder v. Cablevision Sys. Corp., 418 F.3d 187, 198-99 (2d Cir. 2005) (internal citations and quotation omitted). "New York law . . . does not recognize a separate cause of action for breach of the implied covenant of good faith and fair dealing when a breach of contract claim, based on the same facts, is also pled." Harris v. Provident Life & Accident Ins. Co., 310 F.3d 73, 81 (2d Cir. 2002).

Here, Plaintiff's breach of the implied covenant of good faith and fair dealing claim is based upon ETC's alleged failure to provide notice and an opportunity to cure Plaintiff's margin deficiency pursuant to the Agreement. See FAC at ¶ 24. This is the same factual predicate that gives rise to Plaintiff's claim for breach of contract. See id. at ¶¶ 18, 19. Plaintiff's claim for breach of the implied covenant of good faith and fair dealing is therefore redundant and must be dismissed. *See Matsumura v. Benihana Nat'l Corp.*, 465 Fed. Appx. 23, 29 (2d Cir. 2012)

("Plaintiffs based their breach of good faith claim on the same operative facts as their breach of contract claim; accordingly, the District Court did not err in dismissing the former claim as duplicative of the latter."); see also Boart Longyear Ltd. v. Alliance Indus. Inc., 869 F. Supp. 2d 407, 420 (S.D.N.Y. 2012) (dismissing as redundant breach of implied covenant of good faith and fair dealing claim "based on the same factual elements" as breach of contract claim).

As with Plaintiff's breach of fiduciary duty claim, Plaintiff is granted leave to amend his claim for breach of implied covenant of good faith and fair dealing, but only to the extent that it is not duplicative of his breach of contract claim.

IV. CONCLUSION

For the foregoing reasons, ETC's motion to dismiss is granted. Plaintiff's claims for breach of fiduciary duty and breach of the implied covenant of the duty of good faith and fair dealing are dismissed with leave to amend. Any second amended complaint must be filed within 14 days of the date of this order. The court will conduct an initial case management conference on December 7, 2016 at 1:30 p.m. A joint case management statement is due by November 30, 2016.

IT IS SO ORDERED.

Dated: November 9, 2016

Donna M. Ryu
United States Magistrate Judge