ROZSA v. MAY DAVIS GROUP

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O P I N I O N

Defendant S.G. Cowen Securities Corporation has moved to dismiss theclaims set forth in the complaint filed by plaintiff Theodore Rozsa("Rozsa") pursuant to Rule 12(b)(6), Fed.R.Civ.P. For the reasons setforth below, the motion will be granted.

The Parties

Plaintiff Rozsa is an 86 year-old Canadian citizen and a resident ofthe Province of Alberta.

Defendant May Davis Group, Inc. ("May Davis") is a securitiesbroker-dealer incorporated in Delaware and with a place of business inNew York.

At all times relevant to this action, defendant Carl Corley ("Corley")was a Senior Account Executive and Registered Options Principal in theNew York office of May Davis.

Defendant Thomas Baribeau ("Baribeau") is a resident of California whofounded the Nevada corporation, Aid for Humanity and BenevolenceFoundation, Inc. ("the Foundation"), in 1999.

Defendant S.G. Cowen Securities Corp. ("SG Cowen") is a New Yorksecurities broker-dealer that acted as the clearing broker for May Davisat all times relevant to the complaint.

Facts

As required in a motion to dismiss pursuant to Rule 12(b)(6), the factsalleged in the complaint are presumed to be true, and all factualinferences will be drawn in the plaintiff's favor. See Mills v. PolarMolecular Corp., 12 F.3d 1170, 1174 (2d Cir. 1993).

The complaint alleges that in late 1999, Baribeau induced Rozsa to wire$5 million to a sub-account at the Foundation and represented that Rozsawould be the sole signatory of the account, and that the money would beinvested only in money market funds unless Rozsa otherwise directed.Baribeau represented that Rozsa's funds would be deposited at SG Cowen,and would be used only as "proof of funds" for the other Foundation'sdepositors' low-risk, high-yield "program trading" in foreign bankinstruments, and that Rozsa would receive a share of the profits fromeach trade.

On December 10, 1999, Rozsa signed a disclosure election and taxpayeridentificationform to open the account. (Compl. Ex. A.) After Baribeauinformed Rozsa that May Davis was affiliated with or owned by SG Cowen,Rozsa signed and sent to May Davis a Form W-8, Certificate of ForeignStatus on December 13, 1999.

Three days later, Baribeau faxed Rozsa and Corley a letter onFoundation letterhead confirming that the Foundation "released allsignatory rights over any movement of [the contemplated $5 million]deposit with Cowen Securities, account HM10585711, credited FOR THEBENEFIT OF, Mr. Theodore Rozsa." (Compl. ¶ 13, Ex. B.) The letterfurther provided that "only Mr. Theodore Rozsa shall have the authorityto transfer, obligate, or encumber these funds." (Id.) Later on December16th, Rozsa arranged that $5 million be wired from his Bank of Montrealaccount in Calgary to a bank account at the Bank of New York inManhattan, as per Baribeau's instructions. Rozsa sent the wire to bedeposited in the name of SG Cowen Securities Corp., "Ref: May DavisGroup, for further credit to: Aid for Humanity and BenevolenceFoundation, a/c HM10585711 FOR THE BENEFIT OF: Mr. Theodore Rozsa."(Compl. ¶ 14.)

The next day, Corley faxed and mailed a letter on May Davis letterheadwelcoming Rozsa to the May Davis Group and stating May Davis's objective"to help you build your net worth and manage risk." (Compl. ¶ 15,Ex. C.)

Rozsa filled out additional Cowen forms on December 20, 1999, includinga Retail New Account Form and a W-8 Certificate of Foreign Status form,reflecting his ownership of the funds in the account, and sent them toCorley at May Davis by overnight delivery for inclusion in his accountfile.

Rozsa contends that no "program trading" ever took place, and that thisinvestment strategy was fabricated by Baribeau, Corley and May Davis as ameans of fraudulently inducing Rozsa to transfer $5 million into the SGCowen account so they could appropriate it for themselves in subsequentsecret and unauthorized wire transfers to Foundation accounts at otherbanks, and then on to their personal accounts. Specifically, the entire$5 million was wired out of Rozsa's SG Cowen account in unauthorizedtransfers on February 22, 2000, March 9, 2000, March 15, 2000, March 16,2000 and March 17, 2000. Baribeau, Corley and May Davis did not advise ofany of these transfers. However, SG Cowen did send account statements forFebruary and March 2000 reflecting that the wire transfers had takenplace, and that the account balance had dropped to under $100,000 by March31, 2000.

When confronted, Baribeau falsely represented to Rozsa that his fundshad been transferred from May Davis to the Chase Manhattan Bank in NewYork to facilitate "program trading," and that profits were beinggenerated, but no account statements were available because the "tradingcycle" was not yet complete and other depositors and investors were"meddling" and making mistakes." (Compl. ¶ 24.)

On July 31, 2000, Rozsa sent a letter to Corley at May Davis demandingan explanation of the

unauthorized transfers. (Compl. Ex. D.) Corleyfaxed a response on August 6, 2000, in which he acknowledged that he wasRozsa's broker, "not Tom Baribeau's," and falsely representing that hehad not discussed Rozsa or his account or with Baribeau. (Compl. ¶26.)

After becoming aware that the Foundation had a bank account atWashington Mutual Bank in Irvine, California and that some of his moneyhad been transferred to an unidentified bank in South Carolina, Rozsarequested that Corley and May Davis put both banks "on notice."(Compl.¶ 27.) Rather than complying with this request, Corley and May Davisinstead notified Baribeau about the communication from Rozsa to enablehim to transfer any remaining funds out of the Foundation account at RockHill Bank & Trust in Rock Hill, South Carolina.

Baribea u, May Davis and Corley arranged for Rozsa to receive a totalof $1,400,000 between July and September 2000, which they identified as"program trading profits," plus $95,000 in money market interest andcapital gains on the funds in the May Davis account. These were the onlyreturns Rozsa received on his $5 million, which principal has not beenreturned to him.

Procedural History

The complaint, filed on March 27, 2001, alleges that May Davis, Corleyand Baribeau violated the Racketeering Influenced and CorruptOrganizations Act ("RICO") (Count I), that all of the defendants breachedtheir fiduciary duty to Rozsa (Count II), that May Davis and Cowenbreached their contract with Rozsa (Count III), and that all of thedefendants unlawfully converted Rozsa's five million dollars (Count IV).

SG Cowen filed this motion to dismiss on May 11, 2001, in lieu offiling an answer. Rozsa filed a brief in opposition on May 24, 2001, andthe motion was deemed fully submitted after oral argument on June 6,2001.[1]

Discussion

I. Legal Standard for Failure to State a Claim

In reviewing a motion to dismiss under Rule 12(b)(6), review must belimited to the complaint and documents attached or incorporated byreference thereto. See Kramer v. Time Warner, Inc., 937 F.2d 767, 773 (2dCir. 1991). Courts must "accept as true the factual allegations of thecomplaint, and draw all inferences in favor of the pleader." Mills v.Polar Molecular Corp., 12 F.3d 1170, 1174 (2d Cir. 1993) (citing IUEAFL-CIO Pension Fund v. Hermann, 9 F.3d 1049, 1052 (2d Cir. 1993)).Dismissal is warranted only when "it appears beyond doubt that theplaintiff can prove no set of facts in support of his claim which wouldentitle him to relief." Conley v. Gibson, 355 U.S. 41, 45-46 (1957)(footnote omitted). See also Bass v. Jackson, 790 F.2d 260, 262 (2d Cir.1986).

"For purposes of a motion to dismiss, [the Second Circuit has] deemed acomplaint to include any written instrument attached to it as an exhibitor any statements or documents incorporated in it by reference . . ., aswell as public disclosure documents required by law to be, and that havebeen, filed with the SEC, and documents that the plaintiffs eitherpossessed or knew about and upon which they relied in bringing the suit."Rothman v. Gregor, 220 F.3d 81, 88 (2d Cir. 2000) (citing Cosmas v.Hassett, 886 F.2d 8, 13 (2d Cir. 1989); Kramer, 937 F.2d at 774; andCortec Industries, Inc. v. Sum Holding L.P., 949 F.2d 42, 47-48 (2d Cir.1991), cert. denied, 503 U.S. 960, 112 S.Ct. 1561, 118 L.Ed.2d 208(1992)). The documents attached to the complaint as Exhibits A-D areappropriately considered under this standard.

II. Breach of Fiduciary Duty

SG Cowen has moved to dismiss the breach of fiduciary duty claimagainst it on the grounds that the complaint alleges that SG Cowen wasmerely a "clearing broker" that settled trades for May Davisrather thanacting as a personal stockbroker for Rozsa (Compl. ¶¶ 5, 23), and assuch, SG Cowen had no fiduciary duty to Rozsa. In contrast, Rozsacontends that SG Cowen had a fiduciary duty to him because it was astockbroker with whom he deposited funds (Compl. ¶ 11).

A fiduciary relationship exists under New York law "`when one [person]is under a duty to act for or to give advice for the benefit of anotherupon matters within the scope of the relation.'" Mandelblatt v. DevonStores, Inc., 132 A.D.2d 162, 168, 521 N.Y.S.2d 672, 676 (1987) (citationomitted). Under ordinary circumstances, a broker owes no fiduciary dutiesto a purchaser of securities, see Perl v. Smith Barney Inc.,230 A.D.2d 664, 666, 646 N.Y.S.2d 678, 680 (N.Y.App. Div. 1996), exceptthose duties necessarily attendant to the "narrow task of consummatingthe transaction requested." Press v. Chemical Inv. Servs. Corp.,166 F.3d 529, 536 (2d Cir. 1999) (citations omitted).

The complaint alleges that May Davis had direct contact with Rozsa andcoordinated the opening and use of the account at SG Cowen. (Compl.¶¶ 12, 13, 15, 16.) Assuming these facts to be true, May Davis wasfunctioning as an "introducing broker," which but needed the assistanceof a third party, or "clearing broker," to settle and complete theinvestor's transactions. See In re Adler Coleman Clearing Corp.,198 B.R. 70, 73 (S.D.N.Y. 1996); Katz v. Financial Clearing & ServicesCorp., 794 F. Supp. 88, 90 (S.D.N.Y. 1992). As Rozsa's agent, May Davismay well have assumed a fiduciary relationship with Rozsa in connectionwith the agreed upon transaction. See Press v. Chemical InvestmentServices Corp., 166 F.3d 529, 536 (2d Cir. 1999) (discussing split amongNew York courts about existence and scope of fiduciary duty ordinarybroker owes to investor).

In contrast, the complaint specifically alleges that SG Cowen was the"clearing broker" for May Davis. (Compl. ¶¶ 5, 23.) Clearingbrokers, unlike "introducing brokers," generally have agreements withother broker-dealers, rather than individual 10 investors, governing themechanics of order entry, confirmation and the completion of trades. Seeid. Due to this contracting scheme, New York courts have held thatclearing brokers generally have no fiduciary duty to individualinvestors. See Edwards &

Hanly v. Wells Fargo Securities, Inc.,602 F.2d 478, 484 (2d Cir. 1979) ("a clearing agent, is generally underno fiduciary duty to the owners of securities that pass through itshands") (citation omitted), cert. denied, 444 U.S. 1045 (1980); Connollyv. Havens, 763 F. Supp. 6, 10 (S.D.N.Y. 1991) (same); Dillon v.Militano, 731 F. Supp. 634, 636 (S.D.N.Y. 1990) (same); Stander v.Financial Clearing & Services Corp., 730 F. Supp. 1282, 1286 (S.D.N Y1990)(same).[2] This holds true even where, as here, the clearingbroker holds an investor's funds for trading. Flickinger v. Harold C.Brown & Co., Inc., 947 F.2d 595, 597, 599 (2d Cir. 1991) (finding thatclearing broker that kept custody of investor's funds and securities hadno fiduciary duty to him).

Clearing brokers may have a fiduciary duty to investors in certainextenuating circumstances. See, e.g., Goldman v. McMahan, Brafman, Morgan& Co., No. 85 Civ. 2236 (PKL), 1987 WL 12820, *22 (S.D.N.Y. June 18,1987) (finding that complaint adequately made out a claim for clearingagent's breach of fiduciary dutydue to claim that agent "activelyengaged . . . in creating fraudulent trading losses" rather than actingas "a mere conduit."). However, the complaint in this action does notallege any facts, such as, for example, the existence and violation of acustomer agreement between Rozsa and SG Cowen, upon which such a findingcould be based. Cf. Conway v. Icahn & Co., 16 F.3d 504, 509 (2d Cir.1994). Rather, the complaint alleges only that the other defendants"induced SG Cowen . . . to transfer Rozsa's funds. . . ." (Compl. ¶19.)

In short, the complaint fails to allege facts on which the Court couldfind that SG Cowen acted as anything other than a generic clearing agentthat acted only through May Davis. As a result, SG Cowen had no fiduciaryduty to Rozsa.[3] SG Cowen's motion to dismiss the breach of fiduciaryduty claim is granted for failure to plead facts upon which a claim forrelief may be granted.

III. Breach of Contract

SG Cowen next moved to dismiss the breach of contract claim against iton the grounds that the complaint fails to allege that Rozsa and SG Cowenever entered into a written contract. In opposition, Rozsa contends thathis contract claim in fact relies on a theory that when SG Cowen acceptedhis funds, it created either a bailment contract or a "mutuum."

First, the facts alleged do not support a finding that there was a"mutuum." A "mutuum" is a vestige of Roman law defining a loan of moneyor property that may be used by the transferee, who must then returneither the actual money transferred, or its equivalent, to thetransferor. See DeSimon v. Ogden Associates, 88 A.D.2d 472,454 N.Y.S.2d 721, 726 (N.Y.App. Div. 198 2). The complaint alleges onlythat SG Cowen accepted a transfer of funds with a note that the fundswere "for the benefit of Mr. Thoedore Rozsa" (Compl. ¶ 14), not thatSG Cowen was authorized to "use" the funds.

A bailment of money is created under New York law when a special orspecific bank account is created, title to the funds remains with theaccount holder, and the funds are separated from other deposits. SeePeoples Westchester Savings Bank v. Federal Deposit Ins. Corp.,961 F.2d 327, 330 (2d

Cir. 1992). "Whether an account is general orspecific depends upon the mutual intent of the parties." Swan Brewery Co.v. United States Trust Co., 832 F. Supp. 714, 718 (S.D.N.Y. 1993). Absentevidence of intent, New York law presumes that deposits are generalrather than specific. Id. at 718-19. As the court recognized in Hossainv. Rauscher Pierce Refsnes, Inc., 46 F. Supp.2d 1164 (D.Kan. 1999), aninvestor does not seek to have the exact same funds returned afterdepositing them with a clearing broker:

When plaintiff [investor] deposited his money with the defendant [clearing agent], he did not intend for the defendant to return the identical money back to him. To the contrary, plaintiff deposited the money with hopes of increasing the amount of his deposit. Because the deposit cannot be classified as a special deposit, no bailment relationship existed between plaintiff and defendant.

46 F. Supp.2d at 1171 (construing Kansas law, which is analogousto New York law of bailments).

Bailment is a contractual arrangement, the terms of which may be eitherexpress or implied. See Zurich Ins. Group v. Grandurismo, Inc., No. 00CIV 980(AGS), 2000 WL 1677941, *3 (S.D.N.Y. Nov. 8, 2000); U.S. v.$79,000 in Account Number 2168050/6749900 at Bank of New York, No. 96CIV. 3493 (MBM), 1996 WL 648934, *5 (S.D.N.Y. Nov. 7, 1996) ("A bailmentis a contractual arrangement and, as in any contract, both parties mustassent to the relationship . . . A bailment cannot be created absentintent by the alleged bailee to create one."). Where there is no writtencontract, the party asserting a bailment must establish, in light of allthe circumstances, that the parties agreed to a contract with definiteterms. See Charles Hyman, Inc. v. Olsen Indus., Inc., 642 N.Y.S.2d 306,309-10 (N.Y.App. Div. 1996) (citing Cobble Hill Nursing Home v. Henry &Warren Corp., 74 N.Y.2d 475, 482 (1989)).

In Pagliai v. Del Re, No. 99 Civ. 9030 (DLC), 2001 WL 220013 (S.D.N.Y.March 7, 2001), the court intimated that a contract was not required fora bailment to exist. The plaintiff in Pagliai had left a painting withthe defendant art gallery for appraisal, and the defendant subsequentlyplaced the painting for sale at auction by Christie's to pay off anunrelated debt. Although stating in passing that the bailee's consent wasnot required to create a bailment, the Pagliai court also noted that abailment could be established by way of an implied contract, and, infinding that a bailment existed, did not specify whether the defendanthad consented thereto. Id. at *5. Pagl iai stands in direct contradictionto Zurich, in which the Honorable Allen G. Schwartz held that whetherimplied or express, "a defendant as 15 bailee cannot be liable if thereis no contract between the parties to the action." Zurich, 2000 WL1677941, at *3.

The rule that a bailment is contingent on the existence of an expressor implied contract is longstanding. See, e.g., First Nat'l Bank of Lyonsv. Ocean Nat'l Bank, 60 N.Y. 278 (1875) ("Liability is always grounded incontract, and one cannot be made the bailee of another's property withouthis consent."); Coons v. First Nat. Bank of Philmont, 218 A.D. 283,283-284, 218 N.Y.S. 189, 189-90 (N.Y.App. Div. 1926) ("The relationbetween a bailor and a bailee is fixed by contract, either express

orimplied, and the rights and liabilities of the parties must be determinedfrom the terms of the contract, if express, or, if implied, under thegeneral principles of law and the surroundings and attendingcircumstances; but always liability is grounded in contract.").

Given the unique relationship between investor and clearance broker asmediated by the introducing broker, as opposed to typical cases involvingreal property, a defendant clearance broker's consent to an impliedcontract is fundamental to finding that it accepted a bailment of aninvestor's funds.

To establish the existence of a contract under New York law, aplaintiff must allege an offer, acceptance, consideration, mutual assent,and an intent to be bound. Louros v. Cyr, No. 00 CIV 2166 LAP, 2001 WL2392506, *9 n. 5 (S.D.N Y Apr. 17, 2001). The complaint in this actionalleges only that by accepting his $5 million, SG Cowen entered into acontract agreeing, inter alia, to use his funds onlyas authorized byhim, and that it breached that contract by transferring funds out of theaccount without his authorization. (Compl. ¶¶ 43-45.) However, Rozsasent the letters providing these terms to Conley at May Davis, not to SGCowen.

Accordingly, the complaint fails to assert facts from which it can beinferred that SG Cowen assented to the implied contractual terms Rozsaalleges and thereby created a bailment. SG Cowen's motion to dismiss thebreach of contract claim is therefore granted. See, e.g., Kreiss v.McCown DeLeeuw & Co., 37 F. Supp.2d 294, 298 (S.D.N.Y. March 4, 1999)(dismissing breach of contract claim for failure to plead every essentialelement thereof).

IV. Conversion

To withstand a motion to dismiss, a conversion claim must allege (1) anactionable wrong other than breach of contract caused plaintiff'sinjury; (2) plaintiff had ownership of the funds at the time they wereconverted; (3) defendant exercised unauthorized dominion over the funds;(4) the funds were specific and identifiable; and (5) the defendant wasto have treated the funds in a particular manner but they were not sotreated. See Citadel Management Inc. v. Telesis Trust, Inc.,123 F. Supp.2d 133, 148 (S.D.N.Y. 2000). A complaint that offers nofactual basis for inferring conversion must be dismissed. PinnacleConsulants, Ltd. v. Leucadia National Corp., 923 F. Supp. 439, 447 (S.D.NY 1995), aff'd, 101 F.3d 900 (2d Cir. 1996).

The complaint fails to allege facts that support either the third orfifth elements of conversion because, as set forth above, the onlycommunications Rozsa alleges pertaining to the use of the funds arebetween himself and May Davis, not SG Cowen. Moreover, although thecomplaint has attached various correspondence and bank documents, nospecific account information has been alleged. As a result, the complaintfails to allege that the funds were in a specifically identifiableaccount, as required to sustain a conversion claim.

Neither of the cases Rozsa cites deals with the investor/clearancebroker relationship, and both are

inapposite. First, although the courtin Payne v. White, 101 A.D.2d 975, 477 N.Y.S.2d 456, 458-59 (N.Y.App.Div. 1984), noted that "a person entitled to a bank deposit which hasbeen paid to another person without authority . . . has a [conversion]cause of action . . .," that case involved the withdrawal of funds by ajoint account 18 holder rather than the transfer of funds by a clearancebroker who is not alleged to have had a contract with the plaintiff.Moreover, the unauthorized wire transfer in Manufacturers Hanover TrustCo. v. Chemical Bank, 160 A.D.2d 113, 559 N.Y.S.2d 704, 712 (N.Y.App.Div. 1990) stated a conversion claim because the defendant bankspecifically ignored the plaintiff's order to credit the funds to aspecific account. In contrast, the facts alleged here suggest that Rozsaordered May Davis to limit its use of the funds as per their agreement,but that Rozsa had no such agreement with SG Cowen.

SG Cowen's motion to dismiss the conversion claim is granted.

Conclusion

For the foregoing reasons, the motion to dismiss is granted withoutprejudice. Rozsa may replead within thirty (30) days of the date thisopinion is filed.

It is so ordered.

1. SG Cowen has withdrawn its Rule 9(b) motion in light of Rozsa'sacknowledgment that the complaint does not sound in fraud. (Def. Repl.Br. at 7 n. 3.)

2. See also Lester v. Basner, 676 F. Supp. 481, 483-84 (S.D.N Y 1987)(clearing broker is not the agent of introducing broker); Ahn v. Rooney,Pace, Inc., 624 F. Supp. 368, 370-71 (S.D.N Y 1985) (same).

3. Press, supra, did not address the line of casesholding that clearing brokers were fiduciaries and therefore doesnot foreclose this holding. Even if Press could be construed toaddress the question of clearing brokers' fiduciary status, it heldonly "that the duties a broker owes to its client requiresattention to the specific circumstances of the relationship betweenthe broker and the client and the scope of the matters entrusted tothe broker." Kwiatkowski v. Bear, Stearns & Co., Inc.,No. 96 Civ. 4798(JGK), 1999 WL 1277245, *10 (S.D.N.Y. Nov. 29, 1999).As set forth above, SG Cowen had an arm's length relationship withRozsa mediated by May Davis. These specific circumstances do notwarrant a finding that SG Cowen was a fiduciary under the reasoningof Press.