Before
FINRA DISPUTE RESOLUTION, INC.

DAVID DE GROOT,

Claimant,

- against -

E*TRADE SECURITIES LLC

Respondent.

FINRA-DR Case No. 13-00119

POST-HEARING BRIEF OF E*TRADE SECURITIES LLC REGARDING ECONOMIC DAMAGES

TO ARBITRATOR HORNSTEIN:

Respondent E*TRADE SECURITIES LLC ("E*TRADE"), by its undersigned counsel, hereby submits this post-hearing brief in the above-captioned case.

I. Introduction.

The arbitrator's Order of October 2, 2013 requires the parties to "fully brief the issue of <u>economic damages and remedies</u>." (emphasis added). Claimant's brief is not responsive to the order. Claimant's brief merely restates the <u>exact</u> same relief requested at the hearing, in his pre-hearing brief and in his Statement of Claim. As discussed at the hearing and set forth more fully below, Claimant is not entitled to equitable relief where there is an adequate remedy at law.

II. Background and Facts.

E*TRADE Securities, LLC ("E*TRADE") is an electronic, on-line discount brokerage that offers order execution services for low commission prices compared to traditional broker-dealers. The vast majority of E*TRADE's customers conduct business through E*TRADE's website or Interactive Voice Response ("IVR") System, without ever speaking directly to a broker or a customer service representative. E*TRADE communicates its policies and procedures through its website.

Claimant, an employee of Apple Inc. (NASD: AAPL), opened his E*TRADE account in order to participate in Apple's Employee Stock Purchase Program ("ESPP"). On September 7, 2012, Claimant held 119 shares of Apple that he had acquired periodically from December 2008 through July 2012.

On September 7, 2012, Claimant dialed in to E*TRADE's Interactive Voice Response ("IVR") System. The IVR system is a voice recognition and touch-tone phone system that provides customers with a quick and efficient method of accessing account information and placing orders in their accounts. At the hearing, Claimant testified that he placed his order via the IVR because a co-worker incorrectly told him he had to. Evidence introduced at the hearing showed that Claimant had previously placed orders via E*TRADE's website.

Claimant indicated to the IVR system that he wanted to sell shares in his ESPP account. When asked how many shares he wanted to sell, Claimant replied "sell all my shares." Claimant indicated that he wanted to place a market order to sell all his shares. Claimant also indicated that he wanted to receive the proceeds of his sale by check.[1]

[1] As discussed at the hearing, E*TRADE has two IVR systems. The first, which Claimant played a recording of, is for retail brokerage accounts. The second, the Stock Plans IVR system, was also introduced at the hearing. As established at the hearing, the Stock Plan IVR system uses "sell all" as an option while the retail brokerage IVR system requires the customer to enter a quantity. As also established at the hearing, Stock Plan customers frequently elect to sell all shares and the "sell all" feature allows customers to avoid the tax lot selection required to sell

Important to this arbitration is the fact that, before placing the order, E*TRADE's IVR system asked Claimant to confirm the order. Claimant would have had to say "Yes" or press the "1" key on his telephone to confirm the order. If the order was incorrect, Claimant could have said "No" or pressed the "2" key to cancel. Further, at any time during the call, Claimant could have asked the system to "go back" or asked for a customer service representative to assist in placing his trade. Additionally, Claimant could have logged into E*TRADE's website or mobile app and typed his order.

On September 10, 2012, Claimant was advised that E*TRADE would initiate a trade inquiry in response to his complaint. He was advised that he could take market action to limit his losses if he so chose, but that E*TRADE could not advise him as to how to proceed. (E*TRADE Hearing Exhibit C). Claimant took no action during the pendency of the trade inquiry.

At the hearing in this matter, Claimant testified that he repurchased the shares on September 18, 2012 upon the advice of his parents. At the time he executed this transaction, Claimant knew that the trade inquiry had been denied and that his order would stand as placed. Claimant testified that he was advised that E*TRADE would not reverse the trade, that he purchased the shares upon the advice of family, and that no one at E*TRADE advised him to repurchase those shares. Claimant's new found assertions that he made the purchase to comply with E*TRADE's Customer Agreement are speculative, at best.

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only a portion of their stock plan shares. Mr. de Groot would have had to choose from one of his eight tax lots in order to complete a sale of five shares.

Claimant testified that he had intended to sell 5 of his 119 shares, thus leaving 114 shares in his account. However, when Claimant repurchased the shares 11 days later, he purchased 116, not 114, and even added more money to his account in order to complete that purchase. These actions speak more closely to a case of “seller’s remorse” than to an erroneously executed order.

Finally, on September 21, 2012 – three days after Claimant purchased the 116 shares – Apple hit a record high of $705 per share and then fell almost 50% to $385 per share on April 19, 2013. As of the date of this brief, Apple is trading at approximately $550 per share. In March of 2013, Claimant sold 10 shares of AAPL at a price of $463.39 via his iPhone. (E*TRADE’s Hearing Exhibit B, at E*T00212)

III. Response to Claimant’s Brief.

A. Claimant’s Brief is not Responsive to the Arbitrator’s Order.

Claimant’s brief does not discuss **economic** damages as required by the Arbitrator’s October 2, 2013 order. Instead of discussing the economic impact to Claimant of this transaction, Claimant instead simply repeats the equitable relief he sought at the hearing.[2] Specifically, Claimant requests an order requiring E*TRADE to:

1. Adjust Claimant’s account to show 114 shares of AAPL as of September 7, 2012 - requiring E*TRADE to reverse two trades – and then further adjusting the account to reflect the 10 shares Claimant sold in March 2013;

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[2] Claimant mistakenly relies on E*TRADE’s Complete Protection Guarantee (“CPG”) in support of his claim. E*TRADE’s CPG applies only to third-party fraud or identity theft. It is not applicable in Claimant’s situation. Had Claimant submitted a CPG claim, that claim would have been denied.

2. Pay Mr. de Groot $3,400.72 and $121.24; and

3. Issue amended tax forms regarding these transactions.

B. Injunctive Relief is Not Appropriate Where There is an Adequate Remedy at Law.

It is a well-recognized legal principle that equitable relief is only granted where there is no adequate legal remedy to compensate the injured party. This principle is even recognized in FINRA's Arbitrator's Guide, which states: "specific performance requires precise fulfillment of a legal or contractual obligation when monetary damages are <u>inappropriate or inadequate</u>." (emphasis added).

An injunction is a writ or order commanding a person either to perform or to refrain from performing a particular act. Cal. Code Civ. Pro. § 525; *Luckett v. Panos*, 161 Cal. App. 4th 77 (4th Dist. 2008). Whether referred to as specific performance or a mandatory injunction,[3] the result is the same: Claimant seeks an order requiring E*TRADE to take certain actions it would not otherwise be obligated to take.

In regards to this type of relief, California Civil Code § 3422 provides:

> Except where otherwise provided by this Title, a final injunction may be granted to prevent the breach of an obligation existing in favor of the applicant:
> 1. Where <u>pecuniary compensation would not afford adequate relief</u>;
> 2. Where it would be extremely difficult to ascertain the amount of compensation which would afford adequate relief;
> 3. Where the restraint is necessary to prevent a multiplicity of judicial proceedings; or,
> 4. Where the obligation arises from a trust.

(emphasis added).

[3] A mandatory injunction commands an affirmative action by the defendants. A prohibitory injunction commands the defendant from refraining to do some act.

Thus, the relief Claimant seeks is only available to him where he has no adequate remedy at law.

C. Claimant has an Adequate Remedy at Law, Even if He Has Willfully Refused to Provide Evidence to That Effect.

Claimant's brief states that the remedy requested is a fair and common sense means to compensate him for his losses. (Cl's Brief, p. 6). However, the remedy requested does not amount to compensation at all. Claimant cannot ignore his remedy at law solely for the purposes of trying to obtain equitable relief. The closest Claimant's brief comes to discussing his economic damages is one sentence stating: "adjustment of the account is required since Mr. de Groot otherwise would be liable for income tax on shares of stock he did not authorize to be sold." (Cl's Brief p. 4).

Thus, there are economic damages that would compensate Claimant for his loss – Claimant has simply refused to articulate the amount of those damages. Because Claimant did not comply with the Arbitrator's order to submit a brief on **economic** damages, E*TRADE retained a local accounting firm to compute the tax ramifications of Claimant's sale.

Surely Claimant cannot intend to foist all of the tax consequences of the sale onto E*TRADE. Indeed, no matter when Claimant sold his shares, he was going to at least incur long-term capital gains taxes. Moreover, because Claimant elected to repurchase his shares, he presently has an unrealized loss that may benefit him in some future tax year.

As explained in Claimant's Statement of Claim: "shares of Apple stock that Mr. de Groot acquires must be held for a period of at least one year before they can be sold without incurring significantly higher tax liability." While Claimant's description oversimplifies the tax ramifications of the sale, this additional tax impact is the appropriate measure of damages for this case.

There are two relevant figures in determining the tax implications of a sale of employee stock purchase plan ("ESPP") shares. Because the purchase price is usually at a discount to the market, the difference between the fair market value at the time of purchase and the discounted purchase price may have tax ramifications. The other important figure is the difference between the fair market value at the time of purchase and the sales price.

A disqualifying disposition of ESPP shares occurs when an employee sells ESPP shares either (i) less than two years after the ESPP enrollment date or (ii) less than one year after the date of purchase. For shares held less than one year, the difference between the discounted purchase price and the fair market value at the time of purchase is treated as ordinary income and the difference between the fair market value at the time of purchase and the sales price is also treated as ordinary income. In other words, the entire transaction is treated as ordinary income. For shares held more than one year, but less than two years, the difference between the discounted purchase price and the fair market value at the time of purchase is treated as ordinary income, but the difference between the fair market value at the time of purchase and the sales price is treated as long term capital gains.

Under this analysis, 96 of Claimant's 119 shares incurred **zero** additional tax liability because the sale of those shares was a qualified disposition. Of the

23 shares that were sold via disqualifying disposition, the additional taxes incurred are roughly 10% (25%-15%). Claimant testified at the hearing that he earned roughly $50,000 per year working for Apple. Claimant's 2011 tax return indicated that he was in the 25% bracket. Based on his past income and tax brackets, the disqualifying dispositions were not significant enough to move him into a higher bracket. The long term capital gains rate is 15%.

The total expected additional tax as a result of the disqualifying dispositions is **$556.61.** (*see* Exhibit A, Schedule A).

However, the minor tax increase is far overshadowed by the corresponding market losses. As of the date of this brief, Apple is trading at approximately $550 per share. Comparing Claimant's sales price on September 7, 2012 against the current market, Claimant's sale resulted in an additional gain of $15,000 (*see* Exhibit A, Schedule B) by selling all of his shares and retaining the proceeds.

Regardless of the tax consequences, Claimant is far better off having sold his shares at $680.00 per share and paying the incremental additional tax.

IV. Conclusion.

Respondent is not responsible for Claimant's losses. Rather, Claimant's own decision-making caused his loss – if any. For the foregoing reasons, Claimant's claim should be dismissed.

WHEREFORE, Respondent respectfully request that an Order be issued against Claimant:

a. Denying all claims in the Statement of Claim;

b. Assessing the costs and expenses of this proceeding against Claimant;

c. Granting Respondent all such other and further relief as this Panel may deem just and necessary.

Date: December 20, 2013

Respectfully Submitted,

/s/

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9/7/2012
Account: 628-64995
Account Holder: David De Groot

Purchase Date	Plan Period Start Date	Purchase Price	AAPL Shares	Sales Price 9/7/12	Calculated Fees [1]	Sales Price Less Commission	Total Purchase $	Expected Gain 9/7/12	Expected additional Tax
12/26/08-7/30/10	Unavailable	Various	84	$ 680.14	$ 8.30	$ 57,123.71	$ 7,907.21 [2]	$ 49,216.50	[3]
01/31/11	08/02/10	$ 222.57	12	$ 680.14	$ 1.19	$ 8,160.53	$ 2,670.87	$ 5,489.66	[3]
07/29/11	02/01/11	$ 293.28	8	$ 680.14	$ 0.79	$ 5,440.35	$ 2,346.20	$ 3,094.15	[4]
01/31/12	Unavailable	$ 337.24	8	$ 680.14	$ 0.79	$ 5,440.35	$ 2,697.90	$ 2,742.45	[4],[5]
07/31/12	Unavailable	$ 387.76	7	$ 680.14	$ 0.69	$ 4,760.31	$ 2,714.33	$ 2,045.98	[4],[5]

[1] Calculated fees represent "Sales Price Less Commission and Premiums" per the E*Trade 2012 1099 less "Total Sale $" (Sale Price 9/7/12 x # of shares).
[2] Per schedule B
[3] As the period between the Plan Period Start Date and date of sale (9/7/12) is greater than 2 years, there is no expected additional tax.
[4] Shares sold triggered a disqualifying disposition. The difference between the purchase price and the fair market value on the date of purchase is treated as ordinary income and reported on the employee's W-2.

Purchase Date	Cost Basis	Total Purchase $	Expected Ordinary Gain	Difference in Tax Rates (25%-15%)	Expected Additional Tax
07/29/11	$ 3,123.84	$ 2,346.20	$ 777.64	10%	$ 77.76
01/31/12	$ 3,651.84	$ 2,697.90	$ 953.94	10%	$ 95.39
07/31/12	$ 4,275.32	$ 2,714.33	$ 1,560.99	10%	$ 156.10
			$ 3,292.57	W-2 Misc. Comp	$ 329.26

[5] Shares sold were held for less than 1 year and therefore did not qualify for the 2012 long-term capital gain rate of 15%. The difference between the sales price on 9/7/12 and the Cost Basis is treated as short-term capital gain (estimated at ordinary income rate of 25%) to be reported on the employee's 1040 Schedule D.

Purchase Date	Less Commission & Premiums	Cost Basis	Expected ST Capital Gain	Difference in Tax Rates (25%-15%)	Expected Additional Tax
01/31/12	$ 5,440.35	$ 3,651.84	$ 1,788.51	10%	$ 178.85
07/31/12	$ 4,760.31	$ 4,275.32	$ 484.99	10%	$ 48.50
					$ 227.35

Total Expected Additional Tax	**$ 556.61**

David De Groot Analysis

Schedule B: Change in Market Price Calculation

9/7/2012
Account: 628-64995
Account Holder: David De Groot

Purchase Date	Purchase Price	Market Price - 12/2/13	AAPL Shares	Total Calculated Sale $	Total Purchase $	Estimated Fees [1]	12/2/13 Calculated Gain
12/26/08	$ 72.94	$ 551.23	35	$ 19,293.05	$ 2,552.85		
06/26/09	$ 73.62	$ 551.23	32	$ 17,639.36	$ 2,355.79		
12/25/09	$ 120.67	$ 551.23	1	$ 551.23	$ 120.67		
07/30/10	$ 179.87	$ 551.23	16	$ 8,819.68	$ 2,877.90		
			84	$ 46,303.32	$ 7,907.21	$ 8.30	$ 38,387.81
01/31/11	$ 222.57	$ 551.23	12	$ 6,614.76	$ 2,670.87	$ 1.19	$ 3,942.70
07/29/11	$ 293.28	$ 551.23	8	$ 4,409.84	$ 2,346.20	$ 0.79	$ 2,062.84
01/31/12	$ 337.24	$ 551.23	8	$ 4,409.84	$ 2,697.90	$ 0.79	$ 1,711.15
07/31/12	$ 387.76	$ 551.23	7	$ 3,858.61	$ 2,714.33	$ 0.69	$ 1,143.59
							$ 47,248.09

[1] Fees are estimated using the calculated fee amount per the below 9/7/12 Expected Gain calculation.

Purchase Date	Purchase Price	Sales Price 9/7/12	AAPL Shares	Total Sale $	Total Purchase $	Calculated Fees [2]	Expected Gain 9/7/12
12/26/08	$ 72.94	$ 680.14	35	$ 23,805.01	$ 2,552.85		
06/26/09	$ 73.62	$ 680.14	32	$ 21,764.58	$ 2,355.79		
12/25/09	$ 120.67	$ 680.14	1	$ 680.14	$ 120.67		
07/30/10	$ 179.87	$ 680.14	16	$ 10,882.29	$ 2,877.90		
			84	$ 57,132.01	$ 7,907.21	$ 8.30	$ 49,216.50
01/31/11	$ 222.57	$ 680.14	12	$ 8,161.72	$ 2,670.87	$ 1.19	$ 5,489.66
07/29/11	$ 293.28	$ 680.14	8	$ 5,441.14	$ 2,346.20	$ 0.79	$ 3,094.15
01/31/12	$ 337.24	$ 680.14	8	$ 5,441.14	$ 2,697.90	$ 0.79	$ 2,742.45
07/31/12	$ 387.76	$ 680.14	7	$ 4,761.00	$ 2,714.33	$ 0.69	$ 2,045.98
							$ 62,588.74

[2] Fees are calculated by taking the "Sales Price Less Commission and Premiums" per the E*Trade 2012 1099 and subtracting the "Total Sale $" (price x # of shares).

Expected Loss from market price 12/2/13 vs. 9/7/12 $ (15,340.65)