Baritz & Colman LLP Bulletin

**Silence is Golden:
The Perils of Explained FINRA Awards**

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March 18, 2019

*“Remember not only to say the right thing in the right place, but far more difficult still, to leave unsaid the wrong thing at the tempting moment.”*

* Benjamin Franklin

Practitioners in the world of FINRA arbitration know certain truths to be self-evident. One is that unless specifically requested by both sides, Arbitrators are not required to provide explanations for their Awards. We have all seen many large or significant Awards that are maddeningly silent even as they dole out seven-figure sums to delighted claimants.

This Bulletin discusses a recent decision from the Fourth Circuit that highlights the perils to Panels (and prevailing parties) of uttering even the most minimalist explanations for their Awards. (It also provides us a platform to digress about the benefits and detriments of mandatory arbitration of FINRA disputes.)

**the *saroop* decision**

**a. the claims**

In *Interactive Brokers LLC v. Saroop*, C.A. 3:17-cv-127 (E.D. Va. Dec. 18, 2018), [link to Decision] customers of an on-line brokerage firm, Interactive Brokers, commenced a FINRA arbitration proceeding against the firm for the loss of the entire value of their account (hundreds of thousands of dollars).

Claimants alleged that they traded naked short call options on portfolio margin in their Interactive accounts on the advice of an independent advisor, Brar Capital. Brar Capital was unaffiliated with Interactive, and claimants did not allege that Interactive was asked to, or rendered, any investment advice.

Following the Dow’s largest one-day decline in its history, in August 2015, the value of claimants’ accounts decreased by 80%. Claimants alleged that Interactive’s “auto-liquidation” process to address their margin deficiencies wiped out the balance of claimants’ accounts, leaving a six-figure margin debit.

Claimants initially alleged multiple claims, including breach of contract, negligence, violation of state securities statutes, and unjust enrichment. By close of the Hearings, they had reduced it to two: that the securities were ineligible for margin under FINRA Rule 4210, and that Interactive’s liquidation process was unreasonable. Interactive counterclaimed for the debit balance. The parties did not request that the Panel issue an explained decision.

**b. the award**

The Panel awarded claimants all their alleged compensatory damages, plus attorneys’ fees equivalent to 30% of compensatories. Without more, no basis for vacatur here, right? But wait. The Panel also stated in the Award that its ruling was solely “based on [Interactive’s] violation of FINRA Rule 4210,” which governs margin and portfolio margin requirements for member firms. To wit, that “[t]he securities placed in the portfolio margin account were not eligible for that account based on [Rule 4210].”

Oops. Interactive brought an action in Federal District Court seeking vacatur of the Award on the grounds that the Panel had manifestly disregarded the law.[[1]](#footnote-1)\* FINRA rules, such as 4210, do not provide a private right of action for investors. According to the Panel, that was the sole ground for its award to Claimants and dismissal of Interactive’s counterclaim. Interactive also argued that there were no rational bases for the amounts of damages and attorneys’ fees awarded.

The court remanded the Award to the Panel for “clarification.” In response, the Panel made its disregard even more manifest, and reiterated its position that the Panel should “enforce a FINRA rule [4210]” so as not to “provide an opportunity for investors to commit financial suicide by investing in securities that are ineligible for inclusion in a portfolio margin account.” In other words, the Panel was providing to claimants the non-existent private right to relief under FINRA Rule 4210.

And so the court ruled: the court held that “the law is clear that there is no private right of action to enforce FINRA rules,” and that “the arbitrators knew of and understood the law,” and “they ignored it.” (*Slip Op*. at 19.) The court “reinstated” Interactive’s counterclaims, and remanded the dispute “to a new panel of arbitrators.” (*Id.*) Claimants have appealed the court’s decision to the Fourth Circuit Court of Appeals.

What can we learn from the errors of the obdurate *Saroop* Panel? For panels: when crafting an Award, the less said the better – if the parties don’t ask for an explanation, don’t give one. For litigants: if you believe you have a strong case, do not agree to a reasoned or explained Award, lest you prevail and set up the Award for a petition to vacate – and the accompanying protracted court proceedings.

**desirability of mandatory arbitration**

While we’re on the topic (sort of), some observations on the pros and cons of mandatory FINRA arbitration.

**pros:**

1. Awards are generally not appealable, thus avoiding a potentially lengthy and expensive appeal process.
2. FINRA arbitration does not authorize expensive and time-consuming discovery tools such as depositions and written interrogatories.
3. Unlike juries, panels are composed of people familiar – if not expert – in the rules and practicalities of the securities industry.
4. For industry members and reps, there is a perception that panels tend to have a pro-industry bias.

**cons:**

1. No motion practice. A case like *Saroop* appears apt for summary judgment disposition, if not F.R.C.P. 12(b)(6) dismissal.
2. Awards are generally not appealable, so there is no recourse for even the most egregious panel conduct. The decision in *Saroop* was a rarity indeed, and arose out of an unusual misstep by the Panel. In some jurisdictions, such as New York, courts are so arbitration friendly that they will not hesitate to sanction lawyers who bring even facially meritorious petitions to vacate.[[2]](#footnote-2)\*\*
3. While FINRA rules limit discovery, we have encountered many customer and rep agreements that provide for other arbitral forums, such as JAMS or AAA, and such arbitrators often permit depositions and interrogatories – you might as well be in court.
4. While FINRA arbitrator compensation is modest, forums such as JAMS and AAA provide for handsome compensation for arbitrators – often their going hourly rates for their private practices. In one case, a client ended up compensating a single arbitrator in excess of $100,000 for his services. (We prevailed.)

Arbitration agreements continue to be prevalent and enforceable in the securities industry. But it may be time for the industry to reconsider just how much is gained versus how much is lost strategically.

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***Baritz & Colman LLP*** *provides securities arbitration, regulatory, litigation, corporate, employment practices and real estate services to clients nationwide. The firm maintains offices in Boca Raton, Florida, and New York City.*

1. \* “Manifest disregard” is not a basis for vacatur under the Federal Arbitration Act. However, many jurisdiction – both state and federal – provide such a basis. (A topic for another B&CLLP Bulletin, perhaps.) [↑](#footnote-ref-1)
2. \*\* *See, e.g., Digitelcom, Ltd. v. Tele 2 Sverige AB,* 2012 WL 3065345 (S.D.N.Y. July 25, 2012) [↑](#footnote-ref-2)