No. 19-1077

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

INTERACTIVE BROKERS LLC
Plaintiff-Appellee,
v.

ROHIT SAROOP; PREYA SAROOP; AND GEORGE SOFIS,
Defendants-Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA, RICHMOND DIVISION
NO. 3-17-CV-127 (REP)

BRIEF AMICUS CURIAE, BY CONSENT, OF BETTER MARKETS, INC. IN SUPPORT OF THE DEFENDANTS-APPELLANTS AND REVERSAL

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure ("FRAP"), and Rule 26.1 of the Local Rules of this Court ("Local Rules"), Better Markets states the following:

(A) It has no parent corporation and there is no publicly held corporation that owns any stock in Better Markets.

(B) It is unaware of any corporation that has a direct financial interest in the outcome of this litigation by reason of a franchise, lease, other profit-sharing agreement, insurance, or indemnity agreement.

(C) There is no master limited partnership, real estate investment trust, or other legal entity whose shares are publicly held or traded that is a parent of Better Markets or that owns 10% or more of the stock of Better Markets.

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STATEMENT OF IDENTITY, INTEREST, AND AUTHORITY TO FILE OF BETTER MARKETS[1]

Better Markets, Inc. ("Better Markets") is a nonprofit, nonpartisan organization that promotes the public interest in the financial markets through comment letters on proposed rules, litigation, independent research, and public advocacy. It fights for regulatory reforms that create a stronger, safer financial system for the benefit of all Americans. It also advocates for reforms that protect individual investors from fraud, abuse, and conflicts of interest, and it seeks to ensure that investors who are victimized by brokers, financial advisers, or banks have meaningful remedies. *See generally* Better Markets, http://www.bettermarkets.com (including archive of comment letters, briefs, and other materials).

Better Markets' advocacy has focused significantly on arbitration. It seeks improvements to the mandatory arbitration system prevalent in the financial services industry today, so that consumers and investors have at their disposal a simple, expedient, and inexpensive alternative to litigation that consistently provides full and fair remedies for misconduct by financial institutions. Better Markets also seeks to preserve the right of consumers and investors to bring class action claims where

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[1] In accordance with FRAP 29(a)(4)(E), Better Markets states that (i) no counsel for any party authored this brief in whole or in part; (ii) no party or party's counsel contributed money that was intended to fund preparing or submitting this brief; and (iii) no person—other than Better Markets, its members (of which there are none), or its counsel—contributed money that was intended to fund preparing or submitting this brief.

financial institutions have engaged in widespread abuses that victimize a broad swath of the public in comparatively small increments. *See, e.g.,* Better Markets Comment Letter to Consumer Financial Protection Bureau (Aug. 22, 2016), *available at* https://bettermarkets.com/sites/default/files/CFPB-%20CL%20-%20Arbitration%20Agreements-%208-22-16%20%28Searchable%29.pdf (supporting arbitration rule that protected consumers' right to participate in class actions); Better Markets, *The Fight for CFPB Arbitration Rule Is About Ensuring Consumers Can Hold Big Banks Accountable* (Sept. 26, 2017), https://bettermarkets.com/blog/fight-cfpb-arbitration-rule-about-ensuring-consumers-can-hold-big-banks-accountable (reviewing data highlighting the shortcomings of arbitration relative to litigation for consumers); Brief of AARP, AARP Foundation, the American Association for Justice, Americans for Financial Reform, Better Markets, Inc., Consumer Federation of America, and the Public Investors Arbitration Bar Association as Amici Curiae in Support of Defendants, *Thrivent Financial for Lutherans v. Perez,* No. 16-cv-03289-SRN-HB (D. Minn. Dec. 9, 2016), *available at* https://www.aarp.org/content/dam/aarp/aarp_foundation/litigation/pdf-beg-02-01-2016/thrivent-v-perez.pdf. (arguing in favor of a rule allowing investors harmed by widespread or systemic conflicts of interest to seek relief in court via class actions).

Better Markets has an interest in seeking reversal in this case because the district court's decision represents a significant setback for investors who seek justice via arbitration. The court vacated an arbitration award on the ground that the panel based the award on violations of a self-regulatory organization ("SRO") rule, which, the court held, do not give rise to a private cause of action. *Interactive Brokers LLC v. Saroop*, No. 3:17-cv-127, 2018 WL 6683047, at *8 (E.D. Va. Dec. 19, 2018). The court committed error because whatever application its holding may have to civil litigation, it does not preclude recovery under the arbitration agreement entered by the parties in this case. Moreover, even in the context of civil litigation, the proposition that an SRO rule violation can never support a private right of action is not so clearly defined or sufficiently free from doubt to support a finding that the arbitration panel committed manifest disregard of the law.

Unless reversed, the decision will undermine the letter and spirit of the Federal Arbitration Act ("FAA"), which provides that the scope of an arbitration is to be governed first and foremost by the agreement between the parties—in this case, an agreement that afforded ample room for claims based on SRO rule violations. The decision will also limit the range of misconduct for which investors may seek recovery in arbitration, carving out an entire swath of activities prohibited under FINRA rules. Finally, the decision promises to foster a more litigious approach to arbitration, thus undermining the most-often cited virtues of the process: simplicity, expediency, and affordability. In short, Better Markets has an interest in advocating for reversal of the lower court's decision, so that the foundational principles of arbitration remain intact and so that investors subject to fraud and abuse are not further disadvantaged in the arbitration process.[2]

ARGUMENT

I. Under the FAA, the parties' agreement controls the nature of the claims that may be brought in arbitration, as well the procedures that govern, and the Customer Agreement in this case provided ample room for claims based on violations of SRO rules.

The district court based its decision vacating the arbitration award squarely on the proposition that violations of SRO rules, in this case FINRA rules, do not create a private right of action enforceable in court. But that blanket proposition does not apply in arbitration. Under the FAA, the cardinal principle governing arbitration is that the parties' agreement controls. Where, as in this case and in most arbitrations, the parties have agreed that ***any and all*** claims and disputes between them may—indeed must—be heard in arbitration rather than in court, that agreement controls. Thus, regardless of whether a violation of an SRO rule creates a private right of action in civil litigation, such claims are subject to arbitration under the facts of this

[2] Better Markets has authority to file this brief under FRAP 29(a)(2) because all parties have consented to its filing. Counsel for Appellee has stated the following: "The Appellee, Interactive Brokers, consents to the filing of the proposed amicus brief, but notes that it may ask the Court for an extension of its word/page limit to address any arguments the Amici may make that are not duplicative of those made by the Appellants."

case. The district court never addressed this distinction, and it erred in holding that the arbitration award issued in favor of the Appellants could not be supported by violations of FINRA rules.

A. The FAA gives preeminent force to the parties' arbitration agreement.

The FAA establishes the broad principle that agreements to settle disputes by arbitration are valid and enforceable, "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Years of Supreme Court jurisprudence have reaffirmed the point: The parties may choose not only whether to arbitrate but also which substantive and procedural rules will govern the arbitration:

> Arbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit. Just as they may limit by contract the issues which they will arbitrate, *see Mitsubishi, supra,* 473 U.S. at 628, 105 S. Ct. at 3353, so too may they specify by contract the rules under which that arbitration will be conducted.

Volt Info. Sciences, Inc. v. Board of Trustees, 489 U.S. 468, 479 (1989) (parties' agreement adopting state provisions allowing for stay of arbitration did not offend FAA); *see also Hill Street Associates, LLC v. Mattel, Inc.*, 552 U.S. 576, 586 (2008) (parties may tailor many features of arbitration by contract, including arbitrable issues, procedures, and choice of substantive law, although grounds for vacatur and modification set forth in the FAA are exclusive); *EEOC v. Waffle House, Inc.*, 534

U.S. 279, 289 (2002) ("it is the language of the contract that defines the scope of disputes subject to arbitration").

B. The agreement between the parties in this case permits a broad range of claims.

Here, the agreement between the parties is broadly framed: "Customer agrees that ***any controversy, dispute, claim, or grievance*** . . . shall be resolved by arbitration." Interactive Brokers LLC Customer Agreement ("Customer Agreement"), at 10 (emphasis added). Nowhere does the Customer Agreement limit the nature of the claims subject to arbitration or condition the arbitrability of any claims on whether or not they are cognizable as causes of action in civil litigation. To the contrary, the agreement stipulates that the parties "are giving up the right to sue each other in court," *id.* at 9, thus effecting waiver of the substantive and procedural requirements and entitlements that come with civil litigation.

C. The FINRA Code of Arbitration similarly allows a broad array of claims to be arbitrated.

The Customer Agreement expressly incorporates "the rules of the arbitration forum in which the claim is filed, and any amendments thereto," *id.* at 10, thus adopting FINRA's Code of Arbitration for Customer Disputes ("Code"). The Code in turn makes abundantly clear that arbitration claims need not conform to any formal legal theories or pleading requirements:

- It defines the term “claim” to mean simply and broadly “an allegation or claim for relief,” Code, § 12100(e);
- It defines the term “dispute” similarly broadly to mean “a dispute, claim or controversy,” *id.* at § 12100(n);
- It provides that the “Code applies to ***any*** dispute between a customer and a member or associated person of a member that is submitted to arbitration,” *id.* at § 12101(a) (emphasis added); and
- It lists the grounds upon which a claim will be considered “deficient,” which include strictly technical requirements (such as a failure to sign and date the claim) without any reference to the nature or substance of the claims made, *id.* at § 12307(a).

Cf. Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 60-61 (1995) (parties’ incorporation of NASD arbitration rules in their agreement supported conclusion they intended to allow for award of punitive damages).[3]

FINRA’s routine practice for years under the Code confirms that the scope of permissible claims in arbitration is extremely broad and often—in fact typically—

[3] Other arbitration organizations follow a similarly broad approach. For example, under the Consumer Arbitration Rules of the American Arbitration Association, the Demand for Arbitration need only “briefly explain the dispute;” “specify the amount of money in dispute, if applicable; and “state what the claimant wants.” American Arbitration Association, Consumer Arbitration Rules, at R-2(a)(1), *available at* https://www.adr.org/sites/default/files/Consumer_Rules_Web_0.pdf.

includes violations of FINRA rules. For example, FINRA's data show that some of the most common claims addressed in arbitration are based on violations of FINRA rules. *See* 2018 Dispute Resolution Statistics, https://www.finra.org/arbitration-and-mediation/2018-dispute-resolution-statistics. They include "Failure to Supervise" (ranked third among fifteen "Controversy Types") and "Suitability" (ranked fourth); FINRA Rule 3110 (Failure to Supervise); FINRA Rule 2310 (Suitability, formerly Rule 2111); *see also, e.g., In re Strack v. Crown Capital Secs., L.P.*, 2016 WL 3345970, No. 14-02916, *3-4 (June 25, 2016) (arbitration panel considered and reached a decision on suitability claim under FINRA Rule 2111); *In re Silk v. Secs. Service Network, Inc.*, 2013 WL 3788103, No. 11-04569 (July 8, 2013) (panel considered a variety of alleged FINRA rule violations and found violations of Rule 2310 on suitability).[4]

[4] Throughout the decades of NASD- and then FINRA-hosted arbitration, arbitration panels have sometimes summarily asserted that there is no private right of action for violation of SRO rules. *See, e.g., In re Nestos v. Birkelbach Inv. Secs.*, 1991 WL 198022, No. 89-02514, *1 (NASD, Mar. 4, 1991) (and noting that if the panel had authority to award damages for an SRO rule violation, it would have voted unanimously to award damages). The significance of these observations is not clear, since the skeletal awards provide no insight into the analysis underlying the panel's thinking, including, for example, whether and to what extent the terms of the parties' arbitration agreements in those cases may have limited the nature of the claims permitted in the arbitration. In any case, these snippets hardly outweigh the many other authorities, discussed in text *supra*, that clearly establish the right to assert SRO rule violations in arbitration.

Furthermore, high-level officials from FINRA who have overseen the arbitration process have made clear that claimants in their arbitration proceedings are not limited to claims that are cognizable under federal or state law. For example, in 2004, Linda Feinberg, the President and Chief Hearing Officer of FINRA Dispute Resolution, articulated one the benefits of the arbitration process as follows:

> In arbitration, in SRO NASD arbitration, unlike in court, you get an equitable result. ***You do not have to have a claim that is cognizable under state or federal law. It can be cognizable under NASD rules.***

See Linda Fienberg, President and Chief Hearing Officer of FINRA Dispute Resolution, Remarks at the North American Securities Administrators Association "NASAA Listens Forum," National Press Club (July 20, 2004), http://www.connect-live.com/events/nasaa/ (emphasis added). Similarly, in a 2008 comment letter submitted to the SEC, Mignon McLemore, then-Assistant Chief Counsel of FINRA Dispute Resolution, explained that:

> FINRA reminds parties that there are no specific pleading requirements under the Codes. Rules 12302 and 13302 require a claimant to supply only "[a] statement of claim specifying the relevant facts and remedies requested" along with the required fees, copies, and signed submission agreement in order to initiate an arbitration. Similarly, the answer must include only "[an] answer specifying the relevant facts and available defenses to the statement of claim."

See Letter dated September 15, 2008 from Mignon McLemore, Assistant Chief Counsel, FINRA Dispute Resolution, to Securities and Exchange Commission, *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p116990.pdf.

D. <u>The Submission Agreement makes clear that the arbitration in this case was governed and informed by FINRA's substantive rules.</u>

The Submission Agreement, which all of the parties signed, provides that the parties are submitting the matter in controversy "to arbitration in accordance with the FINRA By-Laws, Rules, and Code of Arbitration Procedure." FINRA Arbitration Submission Agreement, at ¶ 1. This language leaves little doubt that the arbitration between the parties was meant to be governed not only by the Code but also by all of FINRA's substantive rule requirements, including Rule 4210. In fact, this incorporation by reference makes little sense unless it means that claims in a FINRA arbitration, involving a FINRA member, may be framed or measured in terms of the standards of conduct set forth in the FINRA rules.

The district court did not address this point. Instead, it focused on different language in the parties' Customer Agreement, providing that "all ***transactions*** are subject to rules and policies of relevant markets and clearinghouses, and applicable laws and regulations." *Interactive Brokers*, 2018 WL 6683047 at *12 (emphasis added). Invoking *Gurfein v. Ameritrade, Inc.*, 312 F. Appx. 410, 412-14 (2d Cir. 2009), the court explained that this language merely puts customers on notice about how trades will be conducted and does not create a cause of action for violation of FINRA's substantive regulations under a breach of contract theory. *Id.*

However, this analysis, whatever its merit, is beside the point here. The important language from paragraph 1 of the Submission Agreement is framed differently and serves a very different purpose than the language cited by the district court and by the court in *Gurfein*. The excerpt from the Submission Agreement is far more relevant, as it specifies how the "***arbitration***" will be conducted, not simply how "***transactions***" for the customer will be conducted, *see Interactive Brokers*, 2018 WL 6683047 at *12. The reference in the Submission Agreement to FINRA's regulatory provisions, in addition to the Code, can only mean that the substance of the arbitration is to be measured according to those regulatory provisions. Contrary to the district court's suggestion, this analysis is not an attempt to contrive a breach of contract claim where no private right of action exists; rather, it shows that under the Submission Agreement, a claim for violating FINRA rules does indeed exist, at least in arbitration.

E. <u>Nor does Connecticut law, adopted under the choice of law provision in the Customer Agreement, restrict claims to rule violations that support private rights of action in civil litigation.</u>

The Customer Agreement provides that it is "governed by the laws of the State of Connecticut, without giving effect to conflicts of laws provisions." Customer Agreement at 8. For its part, Connecticut law does not limit the nature of the claims that may be resolved in arbitration. For example, the Connecticut arbitration statute provides that:

> A person initiates an arbitration proceeding by giving notice in a record to the other parties to the agreement to arbitrate in the agreed manner between the parties, or in the absence of agreement, by certified or registered mail, return receipt requested and obtained, or by service as authorized for the commencement of a civil action. ***The notice must describe the nature of the controversy and the remedy sought.***

Conn. Rev. Unif. Arb. Act, Part I, C.G.S.A. § 52-407ii(a) ("Initiation of arbitration proceeding. Notice") (emphasis added). The predecessor Connecticut statute is similarly broad:

> An agreement in any written contract, or in a separate writing executed by the parties to any written contract, to settle by arbitration ***any controversy*** thereafter arising out of such contract, . . . shall be valid, irrevocable and enforceable, except when there exists sufficient cause at law or in equity for the avoidance of written contracts generally.

C.G.S.A. § 52-408, Agreements to Arbitrate (emphasis added).

The Supreme Court of Connecticut has taken a very broad view of the claims that are subject to arbitration, explaining that "[l]egal as well as factual disputes may be designated by the contract to be within the purview of the arbitrators" and that "doubts regarding whether an issue is arbitrable should be resolved in favor of arbitration." *Fink v. Golenback*, 238 Conn. 183, 195 (Conn. 1996) (holding that arbitration agreement encompassed a wide range of tort claims as well as state statutory claims that could have been addressed in arbitration, thus warranting application of res judicata). In arriving at this view, the court has placed considerable weight on language in the parties' agreements providing for arbitration of "any disputes" arising thereunder, characterizing that phrase as "all-embracing, all-encompassing and broad." *Id.* at 196. The language at issue here in the Customer Agreement is equally broad, if not more so, covering not just "any dispute" but "any controversy, dispute, claim, or grievance."

Thus, the parties' Customer Agreement, the Code incorporated by reference therein, the Submission Agreement, and the body of state law the parties chose to adopt (from Connecticut) all make clear that violations of FINRA rules, including Rule 4210, were appropriately subject to arbitration and could support the panel's award in favor of the Appellants.

II. None of the authorities relied upon by the district court require a different result, as they only address the sufficiency of SRO rule violations as the basis for claims in *federal court* litigation. Moreover, even in civil litigation, the status of SRO rule violations is not so clear as to warrant a finding that the arbitration panel committed manifest disregard of the law.

In holding that violations of an SRO rule—in this case FINRA's rule limiting the types of trades permitted in a portfolio margin account—do not support a private right of action, the district court relied exclusively on case law involving the status of SRO rule violations in ***civil litigation***. Without undertaking any analysis, it extended those holdings to private arbitrations. This was error, because as shown above, arbitration typically accommodates a broad range of claims and controversies, uncabined by formal legal theories applicable to civil litigation.

The court compounded this error by concluding that its cornerstone principle was so clearly defined and free from reasonable doubt that the arbitration panel manifestly disregarded the law by basing its award on violations of the FINRA rule. This too was error, not only because violations of SRO rules can and routinely do support claims in arbitration, but also because even in civil litigation, there is support for the proposition that SRO rules can give rise to a private cause of action.

A. <u>The court cited no authority addressing whether violation of a FINRA rule can support liability in a FINRA arbitration.</u>

The district court relied on case law holding that SRO rules are unenforceable in civil litigation because they do not give rise to private causes of action. The cases cited by the district court concerned whether a ***federal court*** will entertain a claim based on a violation of an SRO's rule. *See, e.g., Carras v. Burns,* 516 F.2d 251, 260 (4th Cir. 1975) (addressing claims brought in federal court for violation of exchange rules); *Weinraub v. Glen Rauch Sec., Inc.,* 399 F. Supp. 2d 454, 462 (S.D.N.Y. 2005) (same); *Thompson v. Smith Barney, Harris Upham & Co.*, 709 F.2d 1413, 1419 (11th Cir. 1983) (same); *Parsons v. Hornblower & Weeks-Hemphill, Noyes*, 447 F. Supp. 482, 494 (M.D.N.C. 1977) (same); *Gurfein v. Ameritrade, Inc.*, 312 F. App'x 410, 414 (2d Cir. 2009) (same).

At no point did the court evaluate the distinctive attributes of arbitration relative to civil litigation, including its fundamentally private and agreement-driven nature, its purposeful lack of formality, the flexible Code provisions governing FINRA arbitration, or even the body of state law—Connecticut's[5]—chosen by the parties in this case to apply to their arbitration.[6]

B. Some authorities hold that SRO rule violations may give rise to private rights of action even in civil litigation, eliminating the overwhelming legal clarity that is necessary to support a finding of manifest disregard of the law.

A finding of manifest disregard of the law requires that the legal principle at issue be "clearly defined and not subject to reasonable debate." *Wachovia Sec., LLC v. Brand*, 671 F.3d 472, 483 (4th Cir. 2012). The district erred in concluding that those conditions were met here, because some court decisions stand for the proposition that SRO violations can indeed support private rights of action in civil litigation. Those decisions, offering plausible rationales, dispose of the notion that the issue is

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[5] The district court observed in a footnote that the parties' contracts included "a choice of law provision stating that Connecticut law governs contract interpretation." *Interactive Brokers*, 2018 WL 6683047, at *1 n. 2. This characterization of the contract unduly narrowed the role of Connecticut law, as in fact, the parties stipulated more broadly that "This Agreement is governed by the laws of the State of Connecticut," with the sole exception of Connecticut's "conflicts of laws provisions." Customer Agreement at ¶ 32.

[6] The district court's blanket insistence that SRO rule violations are not arbitrable is also inconsistent with the Supreme Court's steady expansion over the years of the types of claims that may be resolved and the forms of relief that may be awarded through arbitration. *See, e.g., Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 472 U.S. 614 (1985) (Sherman Act antitrust claims are arbitrable); *Shearson/American Exp., Inc. v. McMahon*, 482 U.S. 220 (1987) (claims under Securities Exchange Act of 1934 are arbitrable); *Rodriquez de Quijas v. Shearson/American Exp., Inc.*, 490 U.S. 477 (1989) (claims under Securities Act of 1933 are arbitrable); *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995) (arbitration agreement permitted award of punitive damages).

sufficiently well-defined and free from doubt to warrant a finding that the panel manifestly disregarded the law.

For example, this Court has indicated that when an SRO rule has been adopted for the purpose of protecting investors, its violation may create a private cause of action. *See Carras v. Burns*, 516 F. 2d 251, 260 (4th Cir. 1975). The Seventh Circuit has embraced the same view. In *Securities Exch. Comm'n v. First Sec. Co.,* 463 F. 2d 981, 988 (7th Cir. 1972), the court had no hesitation in finding not only that the defendant broker-dealer had violated an NASD rule but also that such violations "provide a bases for private damage actions where the rule violated serves to protect the public." *Id.* at 988.

In this case, and contrary to the district court's conclusory view, Rule 4210 clearly ***was*** designed to protect investors, who face substantially increased risks of loss due to the higher leverage that attends trading on a portfolio margin basis. For example, Rule 4210(g)(4) restricts the use of portfolio margining to "eligible participants," which would generally be individuals with sufficient financial sophistication and resources to understand and assume the risks inherent in portfolio margining. Restricting access to portfolio margining clearly evidences FINRA's focus on protecting customers. Similarly, Rule 4210(g)(5) requires that, before opening a portfolio margin account for a customer, a broker must furnish to the customer a disclosure that explains the risks of portfolio margining. Risk disclosure requirements are also a clear indication of a focus on consumer protection.

The Securities and Exchange Commission's release accompanying FINRA Rule 4210 (formerly designated NASD Rule 2520(g)) confirms that the overriding purpose of the rule was and is investor protection:

> FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

See Securities and Exchange Commission; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Making the Portfolio Margin Pilot Permanent, 73 Fed. Reg. 45506 (Aug. 5, 2008). Given Rule 4210's clear focus on customer protection, customers are part of the class for whom the rule was enacted, and accordingly it is reasonable to imply a private right of action for its violation. *California v. Sierra Club*, 451 U.S. 287, 293 (1981) (explaining that a threshold factor in implying a private right of action is determining that the rule is one enacted for the benefit of the plaintiff).

The Second Circuit has similarly acknowledged that SRO rule violations can serve as the basis for civil claims under certain conditions, relying on a somewhat different rationale. In *Colonial Realty Corp. v. Bache & Co.*, 358 F.2d 178 (2d Cir. 1966), described as a "leading case" on private rights of action under SRO rules, the court first made clear that a nuanced analysis is required, then proceeded to recognize that an implied private right of action may be appropriate where the rule in question imposes an "explicit duty unknown to the common law":

> A particular stock exchange rule could thus play an integral part in SEC regulation notwithstanding the Commission's decision to take a back-seat role in its promulgation and enforcement***, and we would not wish to say that such a rule could not provide the basis for implying a private right of action***. What emerges is that whether the courts are to imply federal civil liability for violation of exchange or dealer association rules by a member cannot be determined on the simplistic all-or-nothing basis urged by the two parties; rather, ***the court must look to the nature of the particular rule and its place in the regulatory scheme****…**The case for implication would be strongest when the rule imposes an explicit duty unknown to the common law***.

Id. at 182 (emphasis added). FINRA Rule 4210 quite clearly imposes an explicit duty or prohibition unknown to the common law, and it therefore could support a private right of action under the Second Circuit's test.

The thoughtful approach reflected in this Court, the Seventh Circuit, and the Second Circuit is a far cry from the cursory treatment by the district court in this case. Evidently the court could discern no investor protection component to Rule 4210 because it did not look for one. Similarly, the district court cited *Parsons*, which draws heavily on *Colonial Realty,* but the court nevertheless declined to address the applicability of the Second Circuit's approach to the facts here. *Interactive Brokers,* 2018 WL 6683047, at *10.

In any event, setting aside who actually wins the debate over the ability of an SRO rule violation to give rise to a private right of action, the matter is far from clear. For that reason alone, it cannot support a finding of manifest disregard of the law. The district court conceded as much by characterizing its own formulation of the governing principle as representing "the clear weight of authority." That expression invariably embodies a divergence between two different but plausible legal interpretations, neither of which can be regarded as established beyond doubt. *See GMS Group, LLC v. Benderson*, 326 F. 3d 75, 82 (2d Cir. 2003) (noting that SRO rule violations "arguably" do not support a right of action, but finding no manifest disregard by arbitration panel "even assuming that the NASD rules are 'law'"); *Fernea v. Merrill Lynch Pierce Fenner & Smith, Inc.*, 559 S.W.3d 537, 544 (Tex. App. 2011) (acknowledging a split in authority over private rights of action for SRO rule violations). That in itself should have ended the court's analysis and disposed of the contention that the panel engaged in manifest disregard of the law—especially in light of the extraordinarily narrow scope of judicial review of arbitration awards, "among the narrowest known to law." *Apex Plumbing Supply, Inc. v. U.S. Supply Co.*, 142 F.3d 188, 193 (4th Cir. 1998).

III. The district court's ruling will undermine the principle that the parties may define the scope of their arbitration; limit investors' ability to obtain relief for a broad range of misconduct under SRO rules; and deprive investors of the cardinal benefits of arbitration—informality, speed, and affordability.

The district court's ruling is not only legally incorrect but also misdirected on policy grounds. Unless reversed, the decision will (1) undermine parties' ability to define by agreement the scope of the issues subject to arbitration; (2) restrict the types of misconduct for which investors may seek redress; and (3) complicate the process, thus robbing investors of the core benefits most often associated with arbitration, at least in principle—simplicity, speed, and cost-effectiveness. In short, it will make arbitration worse for investors, who already face significant hurdles in the process.

Arbitration has proven to be a less than perfect mechanism for ensuring that consumers and investors suffering injury at the hands unscrupulous brokers, banks, and other companies have a fair and meaningful avenue of redress. The problems are wide-ranging: Arbitration is typically forced upon consumers on terms that are dictated by their corporate counterparties; arbitration claims are often heard by panels with pro-industry backgrounds and biases; and the relief awarded in arbitration very often falls short of what is necessary to restore the losses suffered by the claimants and the attorneys' fees they were forced to incur. *See* Consumer Financial Protection Bureau, Arbitration Study Report to Congress, pursuant to Dodd–Frank Wall

Street Reform and Consumer Protection Act § 1028(a), Executive Summary (Mar. 2015), *available at* https://www.consumerfinance.gov/data-research/research-reports/arbitration-study-report-to-congress-2015/; Jessica Silver-Greenberg & Michael Corkery, *In Arbitration, a "Privatization of the Justice System,"* N.Y. TIMES (Nov. 1, 2015), *available at* https://www.nytimes.com/2015/11/02/business/dealbook/in-arbitration-a-privatization-of-the-justice-system.html; Jessica Silver-Greenberg & Robert Gebeloff, *Arbitration Everywhere, Stacking the Deck of Justice*, N.Y. TIMES (Oct. 31, 2015), *available at* https://www.nytimes.com/2015/11/01/business/dealbook/arbitration-everywhere-stacking-the-deck-of-justice.html; *cf.* Consumer Federation of America, *A Settled Matter: Mandatory Arbitration Is Against the Law and the Public Interest* (Aug. 21, 2018), available at https://consumerfed.org/wp-content/uploads/2018/08/cfa-mandatory-shareholder-arbitration-white-paper.pdf (addressing the drawbacks of mandatory shareholder arbitration).

This is not to say that arbitration offers no benefits or can never serve as a fair and effective dispute resolution mechanism. Whether or not arbitration can fulfill its promise of consistently delivering justice to wronged consumers and investors, while at the same time providing a simple, expeditious, and less costly alternative to litigation, remains to be seen. But what is clear now is that any judicial decision that imposes further technical limitations on claimants, which disproportionately disadvantage investors and favor industry respondents, is making a flawed system worse. The district court's decision will have precisely this effect, as detailed below.

A. The district court's ruling limits the ability of contracting parties to determine the scope and substance of the disputes they wish to arbitrate.

The district court's decision upends the foundational principle that is supposed to govern arbitration under the FAA: The parties should be free to negotiate and agree upon the substantive, procedural, and remedial scope of their arbitration. While the world of arbitration is not yet marked by such mutual agreement between parties of equal bargaining power, that is nevertheless a laudable goal to be pursued. Unless consumers and investors have the ability to freely choose arbitration, on terms they deem fair and just, arbitration will not fully come into its own as a viable substitute for civil litigation.

Yet the district court's ruling undermines this essential ingredient, holding that notwithstanding the broad terms of the Customer Agreement and the Submission Agreement—which clearly accommodate ***any*** claims or disputes between the parties—claims for violations of SRO rules are, as a matter of law, off limits. The broad freedom to ***limit*** the scope of arbitration by agreement is something that the regulated industry has jealously safeguarded and invoked for years to fend off liability. Unfortunately, the ability to ***expand*** the scope of arbitration by agreement has been significantly curtailed by the court's decision, as it removed a whole swath of claims from the purview of an extremely broad arbitration agreement. The result uniquely disadvantages consumers and investors.

B. The district court's ruling needlessly restricts the ability of investors to recover for wrongful conduct.

Claimants routinely rely on violations of FINRA rules when seeking compensation from bad actors in the financial services industry. Indeed, it stands to reason that those violations are likely to be the source of an investor's injury at the hands of a FINRA member firm. And the data show that FINRA rule violations are in fact among the most common claims submitted to arbitration. *See* discussion *supra* at 8. Yet the court's decision starkly invalidates such claims, narrowing the grounds on which investors can seek redress and limiting the tools available to those already facing formidable challenges in the process. This is unfair.[7]

[7] A corollary concern is that the court's holding will be difficult to administer fairly. The arbitration process under the Code is informal in many respects, as for example, statements of claim need not explicate the precise cause of action and panel decisions need not explain the legal basis for an award. *See* Code at § 12904(f) (awards "may" but need not "contain a rationale underlying the award); Code at § 12904(g) (explained decisions are intended to be "fact-based," requiring only a statement of the "general reason(s) for the arbitrators' decision," without the necessary inclusion of "legal authorities"). Thus, whether or not an FINRA rule violation actually serves as the basis for an arbitration award may or may not ever be known with certainty, and it will depend on a confluence of events—how the claimant frames the case, how the panel couches its award, and even whether a district court decides to probe the underlying basis for that award on a motion to vacate. As a result, under the court's ruling, many claimants will undoubtedly lose the chance to recover for misconduct that violates FINRA rules, while a number of others who may have relied on those same rules to support their claims will fortuitously receive and retain their awards.

C. <u>The court's decision will tend to make arbitration more formal and expensive, burdening investors disproportionately.</u>

The district court's ruling can also be expected to intensify the trend toward increasingly litigious behavior in arbitration and a convergence of arbitration with litigation. The parties to arbitration will feel increasingly compelled to behave ever more like civil litigants, painstakingly fashioning and framing their legal theories, ramping up their motions and briefs, and seeking detailed explanations from panels.

Beyond the arbitration itself, the district court's decision threatens to expand the role of the courts in reviewing arbitration awards, beyond that which Congress intended in the FAA. Affirming the district court's decision on the manifest disregard standard would functionally lower the heavy burden that a party must show to vacate an arbitral award. Parties would be more likely to file motions to vacate, since under the district court's reasoning, they would have an easier path toward establishing that the panel manifestly disregarded the law—a mere showing that the arbitration panel may have made what the reviewing court regards as a legal error would seem to suffice.

These trends will erode the three most often cited advantages of arbitration: its relative informality, expediency, and affordability. *See Mitsubishi Motors Corp. v. Solar Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985) (an arbitration claimant "trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration"). The resulting prospect is the worst of all possible worlds: a dispute resolution mechanism that is more onerous, expensive, and time-consuming, without offering the guarantees of fundamental fairness that attend civil litigation. And the burdens will fall disproportionately on investors, not the brokerage firms with ample resources and skilled attorneys at their disposal.

CONCLUSION

For all of the foregoing reasons, the judgment of the district court should be reversed.

Respectfully submitted,

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Dated: April 19, 2019

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I certify that on April 19, 2019, the foregoing document was served on all parties or their counsel of record through the CM/ECF system. All participants in this case are registered users of the CM/ECF system.

I further certify that on April 19, 2019, the required number of copies of this brief were sent by overnight delivery to the Clerk of the Court.

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