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FINRA Should Limit Brokerages' Post-Arbitration Appeals

By **Ethan Brecher and Ana Montoya** (February 3, 2021, 2:35 PM EST)

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Virtually all customers and licensed employees of Financial Industry Regulatory Authority-regulated broker-dealers are required to arbitrate disputes through FINRA's arbitration division.

Since 2003, there have been 87,704 customer and intra-industry arbitrations filed at FINRA. From 2018 to 2020 there were 6,558 customer cases filed and 4,448 intra-industry cases filed. From 2016 to 2020, a yearly average of 67% of the cases settled and 17% of the cases went to a full decision by arbitrators.

Of those cases that went to decision during that period, customers won damages on average in 40% of the cases. No similar win/loss statistics are available for intra-industry cases.[1]

Brokerage firms, with vast financial resources and the home court advantage at FINRA, have little to complain about when they lose an arbitration. Generally, arbitrators reach fair and equitable results and give all parties a full opportunity to be heard. Many brokerage firms, however, pursue sour grapes appeals when they lose against less financially resourced employees and customers, resulting in a man-bites-dog situation.[2]

Winning plaintiffs should be prepared to defend a favorable arbitration award in court and become familiar with the arguments brokerage firms resort to on appeal.

Analyzed below are four recent appellate decisions that have rejected brokerage firms' playbook of complaints, including that arbitrators are biased and committed legal errors.

In September 2020, the U.S. Court of Appeals for the Eleventh Circuit in Gherardi v. Citigroup Global Markets Inc.[3] emphasized the near-frivolous nature of appeals claiming legal errors by arbitrators: A party "does not get a mulligan in federal court because it identifies a possible legal error in arbitration. No doubt this is a tough rule, but it applies to employer and employee alike."[4]

Similarly, arguments concerning arbitrator bias are strongly disfavored by courts. According to the U.S. Court of Appeals for the Third Circuit's 2015 opinion in Goldman Sachs & Co. v. Athena Venture Partners LP:

> A party should not be permitted to game the system by rolling the dice on whether to raise the challenge during the proceedings or wait until it loses to seek vacatur on the issue. Nor should a party "wait[ ] until [it] los[es] and then almost immediately beg[i]n scouring the internet for anything that might suggest one arbitrator or another was biased against it."[5]

As the U.S. Supreme Court held in Oxford Health Plans LLC v. Sutter in 2013:

> [C]ourts may vacate an arbitrator's decision only in very unusual circumstances. That limited judicial review, we have explained, maintain[s]arbitration's essential virtue of resolving disputes straightaway. If parties could take full-bore legal and evidentiary appeals, arbitration would become merely a prelude to a more cumbersome and time-consuming judicial review process.[6]

The Supreme Court unanimously reiterated this in Henry Schein Inc. v. Archer and White Sales Inc. in 2019:

> When the parties' contract assigns a matter to arbitration, a court may not resolve the merits of the dispute even if the court thinks that a party's claim on the merits is frivolous.[7]

Hence, a suggestion to limit wasteful post-arbitration appeals by brokerage firms: FINRA should enact a rule that broker-dealers be required to pay liquidated damages equal to double the damages awarded in arbitration to the prevailing employee or customer if the firm loses an appeal from an adverse arbitration award.

Gherardi v. Citigroup

In Gherardi v. Citigroup Global Markets Inc.,[8] Citi appealed a FINRA arbitration award of $3.42 million for wrongful termination made in favor of a former top performing employee in Miami. Citi fired the employee after he invoked an internal appeals process to challenge disciplinary action the firm took against him after he confronted two employees who had tried to poach his clients.

Unhappy with its loss, Citi argued that one arbitrator was biased against it, claiming that it discovered shortly after the loss that the arbitrator had failed to disclose an employment dispute that he had with Smith Barney 12 years before he was appointed the arbitration panel. Smith Barney was once part of Citi but by the time of the arbitration had been sold to a competitor.

The U.S. District Court for the Southern District of Florida rejected Citi's bias argument, in part because Citi had tried to remove the arbitrator before the start of the arbitration on this very basis. Not surprisingly, Citi abandoned the bias argument on appeal.

Citi also argued that the arbitrators had made an error of law in awarding the employee damages for wrongful termination when in fact, it claimed, he was an at-will employee. Although the district court accepted this argument, the Eleventh Circuit reversed, holding that that the lower court "erred by substituting its own legal judgement for that of the arbitrators,"[9] finding that the arbitrators interpreted plausibly the anti-retaliation provision in the firm's employee handbook as a limitation on Citi's ability to fire the employee.

The court explained:

> As [the employee] correctly points out, Citi's argument boils down to a claim "that the arbitrators misinterpreted the governing contract."[10]

The court rejected this argument, holding that:

> [I]n valid arbitration agreements, the parties opt out of the public courts and delegate judgment to a private third party. The resulting decision binds all parties equally — employers and employees, plaintiffs and defendants, winners and losers. Citi chose to sign an arbitration agreement with Gherardi. It must now live with the results.

The court's decision in this case reaffirms that merits-based appeals from arbitration decisions are simply not permitted in court; where the arbitrators interpret the parties' contract, "[t]he arbitrator's construction holds, however good, bad, or ugly."[11] The court's stern rebuke of Citi's appeal is a stark reminder that courts will not provide relief to aggrieved arbitration losers.

Torres v. Morgan Stanley

In Torres v. Morgan Stanley Smith Barney LLC,[12] former customers of Morgan Stanley won $260,000 in damages based on the firm's faulty investment advice, and $3 million in sanctions because the firm failed to comply with discovery orders.

Morgan Stanley claimed arbitrator bias, arguing that two of the three arbitrators on the arbitration panel were biased against it on account of incomplete disclosures concerning potential conflicts. The firm also argued that the arbitrators' sanction award was prohibited by governing law.

In December 2020, the Eleventh Circuit rejected the flimsy bias argument, finding that the incomplete arbitrator disclosures that Morgan Stanley griped about were too remote and speculative to show that the arbitrators were biased against it.[13]

The court also found that the arbitrators did not exceed their powers by interpreting FINRA's arbitration rules in sanctioning Morgan Stanley. The court pointed out that Morgan Stanley agreed to arbitrate and to be bound by FINRA's rules, which permit arbitrators to impose monetary sanctions on parties who don't comply with discovery orders.

The court declined to analyze whether FINRA's sanctions were consistent with applicable law, because courts "cannot … review the panel's award for underlying legal error."[14]

The significance in this decision rests in the court's refusal to disturb an extraordinarily large sanction that likely would not have been imposed in court for similar misconduct. Indeed, the case is a harsh reminder that courts will not rescue parties from their own misconduct in arbitration because of the extreme deference courts afford arbitrators to interpret the rules governing the cases over which they preside.

Credit Suisse v. Finn

In Credit Suisse Securities (USA) LLC v. Finn,[15] New York's Appellate Division in April 2020 upheld a FINRA award of over $900,000 in favor of an employee who sought deferred compensation on the basis that he was constructively terminated when the firm closed its U.S. private banking division and thus vested in that compensation upon his termination.

Credit Suisse claimed on appeal that the arbitration panel was prejudiced against it because it declined to postpone the hearing due to the illness of a witness, declined to hear some of its evidence, and that the award was in "manifest disregard of the law."

The court disagreed, finding that the panel acted reasonably in its exclusion of evidence that the court concluded was cumulative and that it properly declined to adjourn the hearing, because the testimony of the witness in question was available by videotape.

The court also determined that the panel's award did not disregard any well-established law, "since the law is not clear that its announcement of the closing of the U.S. private banking division, i.e., respondent's inevitable termination, did not constitute a constructive discharge."[16]

This case is emblematic of a losing brokerage making a kitchen sink-styled appeal from an adverse arbitration ruling. The court's firm rejection of Credit Suisse's appeal raises doubts about whether the firm's appeal was brought in good faith, or instead, for dilatory purposes and to warn other employees that they will face years of difficult litigation to collect on an arbitration award even if they win.

That is, brokerage firms as sophisticated parties know they aren't likely to prevail on appeal, but instead purposefully use the appeals process as a mechanism to ward off other claims.

Barclays v. Urquidi

In Barclays Capital Inc. v. Urquidi,[17] Barclays moved to vacate a FINRA arbitration award which rendered unenforceable promissory notes totaling $3.8 million executed between Barclays and two employees.

Barclays claimed in court that one of the arbitrators was biased, asserting his former accounting firm had been retained to give expert testimony in a similar case, and that the arbitrators exceeded their authority purportedly by ignoring the plain language of promissory notes, which required repayment. Barclays abandoned the bias argument on appeal after the Southern District of Florida rejected it.

The Eleventh Circuit affirmed the district court's order confirming the award and found that the arbitrators did not improperly disregard the plain terms of the promissory notes, but rather made a determination as to their non-enforceability in light of Barclays's breaches of its duties to the employees, which occurred when Barclays abandoned the business for which it had hired the brokers to pursue.

The court held that while the arbitration panel:

> [P]rovided no written reasons for its award, we can infer reasonably that the panel agreed with Claimants' position that Barclays's conduct rendered the unenforceable. The enforceability of the [promissory notes] was a matter that was properly before the arbitration panel.[18]

This case is especially notable for the fact that the court viewed its deference to arbitration as so great that it would not disturb an arbitration panel's refusal to enforce the plain language of boilerplate promissory notes. In effect, the court reaffirmed what FINRA writes in its arbitrator's guide, which is that in arbitration, equity prevails over the written law.[19]

Brokerage firms are wont to pursue a cynical "heads I win, tails you lose" approach to arbitration, finding bias where none exists and improperly arguing that the arbitrators committed legal error. While these arguments cause undue delay and expense to prevailing customers and employees, they generally fail to persuade courts to vacate arbitration decisions.

Indeed, these appeals are "the paradigmatic case of the 'sore loser' … trying for a second bite at the apple — and the exact type of case the law disfavors," the Third Circuit said in Goldman Sachs v. Athena Venture Partners.[20]

Perhaps the proposed rule change suggested above might cause brokerage firms to rethink their disregard of the Supreme Court's admonition against challenging arbitration awards in court.

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Disclosure: The firm represented the employee in the Citigroup v. Gherardi case cited in this article.

[1] These statistics are derived from FINRA's Dispute Resolution Statistics webpage. https://www.finra.org/arbitration-mediation/dispute-resolution-statistics#arbitrationstats.

[2] Rostad and Rostad Corp. v. Inv. Mgt. & Research, Inc., 923 F.2d 694, 697 (9th Cir. 1991) ("This appeal is a kind of man bites dog case in that a brokerage firm attacks an arbitration award. Having enthusiastically welcomed the enforcement of agreements to arbitrate, the securities industry might be expected not to encourage retrial of a case in a federal court.").

[3] Gherardi v. Citigroup Glob. Markets Inc., 975 F.3d 1232, 1235, petition for rehearing and rehearing en banc denied, (11th Cir. 2020).

[4] Section 10 of the Federal Arbitration Act (FAA) permits a court to vacate an arbitration award "(1) where the award was procured by corruption, fraud, or undue means; (2) where there was evident partiality or corruption in the arbitrators, or either of them; (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made." A judicially created grounds for vacatur, where the arbitrators act in "manifest disregard of the law," is recognized in some circuits, but the viability of this standard is doubtful in light of Hall St. Assoc., L.L.C. v Mattel, Inc., 552 U.S. 576 (2008).

[5] Goldman, Sachs & Co. v Athena Venture Partners, L.P., 803 F.3d 144, 150 (3d Cir. 2015).

[6] Oxford Health Plans LLC v. Sutter, 569 U.S .564, 568 (2013).

[7] Henry Schein, Inc. v. Archer and White Sales, Inc., 139 S. Ct. 524, 530 (2019).

[8] 975 F.3d 1232.

[9] Id. at 1235.

[10] Id. at 1239.

[11] Sutter, 569 U.S. at 573.

[12] No. 20-11535, 2020 WL 7258540, at *1 (11th Cir. Dec. 10, 2020).

[13] 2020 WL 7258540, at *2 ("When a party seeks to establish a potential conflict based on nondisclosure, the party must establish that the undisclosed facts create a 'reasonable impression of partiality. [T]he mere appearance of bias or partiality is not enough to set aside an arbitration award. Instead, the alleged partiality must be direct, definite and capable of demonstration rather than remote, uncertain and speculative." (internal quotations and citations omitted).

[14] Id. at *5.

[15] 182 A.D.3d 493, 494, 122 N.Y.S.3d 300 (1st Dep't 2020), leave to appeal denied, 35 N.Y.3d 916, 157 N.E.3d 138 (2020).

[16] Id.

[17] 786 F. App'x 970 (11th Cir. 2019).

[18] Id at 974.

[19] FINRA's January 2021 Arbitrator's Guide, at page 9 ("Equity is justice in that it goes beyond the written law. And it is equitable to prefer arbitration to the law court, for the arbitrator keeps equity in view, whereas the judge looks only to the law, and the reason why arbitrators were appointed was that equity might prevail.") https://www.finra.org/sites/default/files/arbitrators-ref-guide.pdf.

[20] 803 F.3d at 150.