CASES & MATERIALS

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Supreme Court Rules that Arbitration Agreements Apply to "Wholly Groundless" Cases

Henry Schein, Inc. v. Archer & White Sales, Inc., 586 U.S. ____, 139 S. Ct. 524 (January 8, 2019)

Under the Federal Arbitration Act ("FAA"), parties to a contract may agree that an arbitrator rather than a court will resolve disputes arising out of a contract. Despite the contract delegating the arbitrability question to an arbitrator, some federal courts have decided the arbitrability question if the dispute is "wholly groundless." The question presented in this case is whether the "wholly groundless" exception is consistent with the FAA.

Respondent Archer & White Sales sued petitioner Henry Schein alleging violations of federal and state antitrust laws and seeking both money damages and injunctive relief. The relevant contract between the parties provided for arbitration of any dispute arising under or related to the agreement, except for actions seeking injunctive relief. Invoking the FAA, Schein asked the district court to refer the matter to arbitration. Archer & White argued that the dispute was not subject to arbitration because their complaint sought injunctive relief as a remedy. Schein contended that because the rules governing the contract provided that arbitrators have the power to resolve arbitrability questions, an arbitrator and not the court, should decide whether the arbitration agreement applied. Archer & White countered that Schein's argument for arbitration was "wholly groundless", so the district court could resolve the threshold arbitrability question. The district court agreed with Archer & White and denied Schein's motion to compel arbitration. The Fifth Circuit affirmed, 878 F.3d 488 (5th Cir. 2017).

The Supreme Court reasoned that when a dispute arises, the parties sometimes disagree not only about the merits of the dispute, but also about the threshold arbitrability question or whether their arbitration agreement applies to the dispute at issue. The court determined that under the Act, the question of who decides arbitrability is itself a question of contract. The Act allows parties to agree by contract that an arbitrator, rather than a court, will resolve threshold arbitrability questions as well as underlying merits disputes. *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63, 68−70 (2010); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943−944 (1995). The parties to such a contract may agree to have an arbitrator decide not only the merits of a

dispute, but also the "gateway questions of arbitrability". *Id*., at 68– 69. Therefore, the court reasoned that when the parties' contract delegates the arbitrability question to an arbitrator, a court may not override the contract, even if the court thinks that the arbitrability claim is wholly groundless. The Supreme Court further reasoned that arbitrators are capable of efficiently disposing of frivolous cases and deterring frivolous motions, and such motions do not appear to have caused a substantial problem in those circuits that have not recognized a "wholly groundless" exception.

The Supreme Court held that the FAA does not contain a "wholly groundless" exception. In this case, the Supreme Court determined that it was not at liberty to rewrite the statute passed by Congress and signed by the President. The court reasoned that when the parties' contract delegates the arbitrability question to an arbitrator, the courts must respect the parties' decision as embodied in the contract. As a result, the Supreme Court vacated and remanded this case to the Fifth Circuit to decide whether the contract at issue delegated the arbitrability question to an arbitrator.

Second Circuit Addresses Pleading Requirements and Net-Out-Of Pocket Damages

Negrete vs. Citibank, N.A., No. 17-cv-2783 2019 U.S. App. LEXIS 85 (2d Cir., January 3, 2019)

Plaintiffs-Appellants Eduardo and Gervasio Negrete (collectively, "the Negretes"), maintained several bank accounts with Defendant-Appellee Citibank. The Negretes' trading primarily consisted of placing "limit" and "market" orders. Citibank added an undisclosed markup to the Negretes' orders and, at times, affirmatively lied to the Negretes and denied that Citibank was adding such a markup. Citibank also declined to execute trades on behalf of the Negretes. When the Negretes noticed such an occurrence, they called Citibank to inquire and they made such an inquiry approximately 150 times. The individuals on the Latin American trading desk specifically assured the Negretes that Citibank was not adding markups to their trade instructions. At times, Citibank would also partially fulfill an order to retain inventory at a more advantageous price to Citibank.

The Negretes asserted six claims for relief: (1) fraud by omission for the undisclosed markups; (2) fraudulent misrepresentation regarding the undisclosed markups; (3) breach of the agreements regarding the undisclosed markups; (4) breach of the agreements regarding the erroneous calculation of the Negretes' collateral, and "making wrongful margin calls"; (5) breach of the covenant of good faith and fair dealing; and (6) fraud regarding the margin

calls. The district court held that the Negretes' claims for covering trades at a later time at a worse price than the contract price, were adequately pled to survive the motion to dismiss because they pled actual damages. The court dismissed all other claims. This appeal followed.

The Second Circuit held that the district court properly dismissed the Negretes' breach of contract claims by finding that the claims for undisclosed markups do not adequately allege a breach by Citibank. The court reasoned that nothing in the agreements or alleged to have occurred in the telephone conversations in which the transactions were ordered prohibit Citibank's undisclosed markups. The court further held that the Negretes failed to sufficiently allege breach of contract with respect to the alleged erroneous margin calls. The district court held that the Negretes' failure to use the required dispute resolution provision to contest margin calls under the agreements invalidated the claims of invalid margin calls, noting that such dispute resolution provisions have been held enforceable by courts within the Second Circuit. (citing *VCG Special Opportunities Master Fund Ltd. v. Citibank, N.A.*, No. 08 Civ. 1563 (BSJ), 2009 WL 311362, at 2 (S.D.N.Y. Jan. 29, 2009) (holding that a party's failure to invoke a dispute resolution provision precludes the party from later challenging its counterparty's "request for additional collateral without having first vetted [its] claim in the manner agreed upon in the . . . Contract.")). The court reasoned that even if the Negretes "complained" about certain margin calls that Citibank made, as they argue on appeal, their claim does not allege that the Negretes complied with the dispute resolution procedure set forth in the Agreements. The court determined the Negretes' breach of contract claims based on Citibank's allegedly erroneous margin calls were therefore properly dismissed by the district court as waived.

The court further held that the breach of covenant of good faith and fair dealing claim was duplicative of the breach of contract claims. The First Amended Complaint alleges that Citibank breached the covenant of good faith and fair dealing by taking and failing to disclose markups, and erroneously calculating their collateral and making associated wrongful margin calls. The district court held that these claims were duplicative of the breach of contract claims and dismissed them. (quoting *Harris v. Provident Life & Accident Ins.*, 310 F.3d 73, 81 (2d Cir. 2002) (explaining that an implied covenant claim "will not stand if it is duplicative of a breach of contract claim.")). The court held that these claims were properly dismissed for the reason stated by the district court.

The court further held that the district court properly dismissed the Negretes' fraud claims because the Negretes failed to allege fraud regarding the undisclosed markups. The court agreed that the district court correctly held

that the Negretes' claimed damages for fraud, based on Citibank's alleged misrepresentations about not charging markups, were all barred from recovery by New York's "out-of-pocket" rule, because the damages alleged were the profits that the Negretes would have made were it not for the allegedly fraudulent markups. The court reasoned that under New York's "out-of-pocket" rule, "there can be no recovery of profits which would have been realized in the absence of fraud" because "[d]amages are to be calculated to compensate plaintiffs for what they lost because of the fraud, not to compensate them for what they might have gained." *Lama Hldg. Co. v. Smith Barney Inc.*, 88 N.Y.2d 413, 421 (1996). "[T]he rationale for the out-of-pocket loss rule [is] that losses based on 'a hypothetical lost bargain [are] too undeterminable and speculative to constitute a cognizable basis for damages.' A misrepresentation is tortious, therefore, only if it causes out-of-pocket losses. To hold otherwise would lead courts to award damages based solely on a 'speculative . . . allegation that [the plaintiff] was injured at all.'" *AHW Inv. P'ship, MFS, Inc. v. Citigroup Inc.*, 661 Fed. App'x 2, 4-5 (2d Cir. 2016) (quoting *Starr Found. v. AIG, Inc.*, 76 A.D.3d 25, 28 (1st Dep't 2010)).

The court held that the district court properly dismissed the Negretes' claim for fraud for erroneous margin calls as duplicative of the breach of contract claim for margin calls. In so holding the district court relied on *Bridgestone/Firestone, Inc. v. Recovery Credit Servs., Inc.*, 98 F.3d 13, 20 (2d Cir. 1996). In that case this court held that where a claim for fraud is based on facts underlying breach of contract, the "plaintiff must either: (i) demonstrate a legal duty separate from the duty to perform under the contract . . .; or (ii) demonstrate a fraudulent misrepresentation collateral or extraneous to the contract . . .; or (iii) seek special damages that are caused by the misrepresentation and unrecoverable as contract damages." *Bridgestone/Firestone, Inc.*, 98 F.3d at 20. The First Amended Complaint alleged that pursuant to the agreements, Citibank was responsible for calculating Plaintiffs' collateral for the purposes of determining when to make margin calls. The court held that the Negretes set forth no reasoned argument as to how misstatements of these calculations, which they alleged Citibank was required to make under the contract between the parties, were not in fact germane to the contract and therefore not collateral or extraneous to it.

Lastly, the court held that the motion for partial summary judgment was properly denied. The court reasoned that the district court could not have granted partial summary judgment to the Negretes for liability on their breach of contract claims because the district court correctly found that the First Amended Complaint did not allege valid damages and the Negretes had failed to plead a breach of contract claim sufficient to survive the motion to

dismiss. *Bigio v. Coca-Cola Co*., 675 F.3d 163, 178 (2d Cir. 2012). The court considered all the Negretes' arguments and concluded that they were without merit. Accordingly, the amended judgment of the district court was affirmed.

FINRA Award Vacated for Manifest Disregard of the Law

Interactive Brokers LLC vs. Saroop, 3:17-cv-127, 2018 U.S. Dist. LEXIS 214023 (E.D. Va., December 18, 2018)

This matter came before the Court on Interactive Broker's Motion to Vacate a Modified Arbitration Award and the investors' Motion to Confirm the Modified Arbitration Award. This case was previously before the court on Interactive's first motion to vacate in which the court remanded the arbitration decision back to the same panel of arbitrators for clarification. The panel issued a modified award again in favor of the investors. Interactive moved to vacate the award and the investors moved to confirm for a second time.

Claimants in the underlying arbitration, a husband and wife as well as another individual, had trading accounts with Interactive Brokers, an online brokerage firm that provides no financial advice to its customers. Claimants were using the services of an independent financial advisor for financial advice. During the time Claimants held an account with Interactive, their financial advisor engaged in a high-risk trading strategy that relied on naked short call options and margin trading. These strategies initially resulted in large profits for the Claimants, but that ended in 2015 when Claimants' accounts decreased by 80 percent. This decline in the value of the Claimants' accounts caused the accounts to fall into "margin deficiency" in which the equity remaining in the accounts fell below the minimum maintenance requirements. This margin deficiency, in turn, triggered Interactive's "auto-liquidation" procedures, which, in a period of about thirty minutes, wiped out the remaining balance in the Claimants' accounts and left them with a large margin deficiency.

The Claimants responded by bringing a FINRA arbitration claim against Interactive, alleging a variety of claims. Interactive counterclaimed for the margin deficiency in Claimants' brokerage accounts. After hearings, the panel awarded Claimants the full value of their accounts on the day before the markets turned volatile, as well as attorneys' fees, and denied Interactive's counterclaim. The panel's award contained a short explanation that it denied Interactive's counterclaim because, under FINRA Rule 4210, it should not have allowed Claimants to trade on margin. Interactive moved to vacate and Claimants moved to confirm the award.

After considering the parties' motions to confirm and vacate the first arbitration decision, the Court did neither. Rather, it denied both motions, and remanded the matter to the original arbitrators to clarify their opinion. The court recognized the extreme deference owed to arbitrators' decisions. However, the court reasoned that "[w]hen an arbitrator does provide reasons for a decision, and when those reasons are so ambiguous as to make it impossible for a reviewing court to decide whether an award draws its essence from the agreement, the court may remand the case to the arbitrator for clarification." *Cannelton Indus., Inc. v. Dist. 17, United Mine Workers of Am.,* 951 F.2d 591, 594 (4th Cir. 1991). The court found the first arbitration decision to be a situation where remand was warranted. First, the court reasoned that it could not concoct a scenario where the amount of compensatory damages awarded in the arbitration made sense. The court further found that it could not determine what the arbitrators considered to be the predicate for liability. The court reasoned that the first arbitration decision was especially perplexing because it stated the arbitration panel found that any and all claims for relief not specifically addressed, including punitive damages, were denied. The court held that the damages awarded to the Claimants did not correspond to any theory of liability that the court could comprehend, much less the two principal theories of liability articulated by the Claimants at the arbitration. Second, the court found the award of attorney's fees perplexing. The court found a possible legal basis for the award of such fees but found that nothing supported the finding of the percentage of fees. Accordingly, the court concluded that the fee awarded also needed to be clarified.

The court determined that it simply could not reconcile the first arbitration decision with any legal theories with which it was familiar, and the court refused to rubber stamp a decision it could not understand. The second modified decision added only a few sentences to the first arbitration decision and the court found it was not very helpful. Section 10 of the Federal Arbitration Act sets out the specific, limited grounds upon which an arbitral award may be vacated, including manifest disregard of the law. Manifest disregard of the law requires the moving party to show that the arbitrator was "aware of the law, understood it correctly, found it applicable to the case before [him], and yet chose to ignore it in propounding [his] decision. *Long John Silver's Restaurants, Inc. v. Cole*, 514 F.3d 345, 349 (4th Cir. 2008). This standard is "not an invitation to review the merits of the underlying arbitration," and will apply only where: "(1) the disputed legal principle is clearly defined and is not subject to reasonable debate; and (2) the arbitrator refused to apply that legal principle." *Jones v. Dancel*, 792 F.3d 395, 402-03 (4th Cir. 2015). A district court cannot overturn an arbitration award "just

because it believes, however strongly, that the arbitrators misinterpreted the applicable law." *Id.* at 401. The arbitrators must disregard it.

With this framework in mind, the court reviewed the merits of the case, fully aware of its limited role in reviewing the arbitration decision. The court reasoned that the arbitration decision must comport with the law. After thoroughly reviewing the record in this case, especially considering the specific instructions that the court gave the arbitrators in the Remand Opinion, the court concluded that the arbitrators based their finding of liability against Interactive on a violation of FINRA Rule 4210. The court held that this is a manifest disregard of the law because the law is clear that there is no private right of action to enforce FINRA rules; the arbitrators knew of and understood the law on this point; they found it to be applicable to the case; and they ignored it. The court held that when manifest disregard for the law occurs, the court must vacate the arbitration award. The court further reasoned that because the arbitrator's impermissible finding of liability is the basis for the damages and attorney's fees award against Interactive, those findings are also erroneous. Lastly, because the arbitrators dismissed Interactive's counterclaims based on the alleged violation of FINRA Rule 4210, the court reinstated those claims and remanded the case to a new panel of arbitrators for consideration. The court granted the brokerage firm's Motion to Vacate the Modified Arbitration Award and denied the investors' Motion to Confirm. The court remanded this matter to a new panel of FINRA arbitrators for reconsideration of Interactive's counterclaims.

FINRA Award Vacated on Arbitrator Bias

Millman vs. UBS Financial Services Inc. & Sahu, No. CPF-18-516349 (Cal. Super. Ct., San Francisco Cty., November 19, 2018)

The court in this matter reviews an arbitration award providing that Petitioner's claims are denied in their entirety and ordering Petitioner to pay $32,666.66 out of $35,000 total administrative fees. Petitioner moves to vacate the arbitration award on three grounds: 1) an arbitrator failed to disclose within the time for disclosure a ground for disqualification of which the arbitrator was then aware; 2) the FINRA panel failed to record an arbitration session; and 3) the award was procured by corruption, fraud, or other undue means. Pursuant to FINRA rules, the Arbitrator in question, Arbitrator Smith was required to complete and submit to the parties an Arbitrator Disclosure Checklist prior to being selected as a panelist for the arbitration. Arbitrator Smith responded in the negative to questions about whether he had interactions with counsel for

the parties, the parties themselves and whether he was presently serving as an arbitrator in other proceedings involving any of the parties or their counsel.

After the conclusion of the arbitration, Petitioner learned that Arbitrator Smith had failed to disclose that he had previously presided over other arbitrations involving the Respondent's attorney, that he had conducted a prior arbitration with UBS, and that he was currently involved in another UBS matter involving the same UBS counsel. Petitioner alleged that if she had been aware of this information prior to the arbitration, she would not have consented to Arbitrator Smith being part of the panel.

Respondent argues that if Petitioner had researched the matters listed on Arbitrator Smith's Disclosure Report, Petitioner would have discovered Arbitrator Smith's prior involvement with opposing counsel and UBS. However, "a party to arbitration is not required to investigate a proposed neutral arbitrator in order to discover information, even public information, that the arbitrator is obligated to disclose. Instead, the obligation rests on the arbitrator to timely make the required disclosure. The fact that the information is readily discoverable neither relieves an arbitrator of the duty to disclose nor precludes vacating the award based on the nondisclosure." *Mt. Holyoke Homes, L.P. v. Jeffer Mangels Butler & Mitchell, LLP*, 219 Cal.App.4th 1299, 1313 (2013). The court reasoned that Arbitrator Smith' s answers to the questions on the Checklist misled Petitioner to believe that the Arbitrator had no prior history with UBS or opposing counsel and his failure to make these disclosures constitutes grounds to vacate the arbitration award. "If an arbitrator failed to disclose within the time required for disclosure a ground for disqualification of which the arbitrator was then aware, the trial court must vacate the arbitration award." *Haworth v. Sup. Court*, 50 Cal.4th 372, 381 (2010); *see also Benjamin, Weill & Mazer v. Kors*, 195 Cal.App.4th 40, 73 (2011).

In addition to Arbitrator Smith's failure to make the disclosures required by the FINRA rules, the arbitration panel failed to record all the proceedings as required by FINRA Code Rule 12606. The court held that this prejudiced Petitioner as she was not able to substantiate her allegations that Arbitrator Smith exhibited bias against her by asking objectionable questions such as the name of her boyfriend, and by scowling at her. The court also reviewed the ex parte communication between Arbitrator Smith and counsel for Respondent. FINRA Code Rule 12210 and FINRA's guidelines proscribe ex parte communications between the parties, parties' agents, and an arbitrator. "[E]x parte communication between a party's representative (whether counsel or party arbitrator) and a neutral arbitrator is not part and parcel of the business of litigation. Indeed, courts have vacated awards on such basis." *Masso v.*

Signer, 203 Cal.App.4th 362, 373 (2012); *see also Pacific & Arctic Ry. & Navigation Co. v. United Transp. Union*, 952 F.2d 1144 (9th Cir. 1991).

The court reasoned that even if the record does not support vacating the arbitration award on this basis alone, ex parte communications undermine the fairness and integrity of the arbitration process. The court reasoned that it understood California favors arbitration as an efficient means of dispute resolution. The court further reasoned that since arbitration is the primary means of resolving disputes in the securities industry, the public perception of its fairness is of paramount importance. The court found that the parties have the right to select arbitrators who they believe will be fair and impartial in rendering their decisions. The court found that in this case Arbitrator Smith violated the disclosure rules. His failure to fully disclose his prior interactions with opposing counsel and UBS interfered with Petitioner's right to select an arbitrator who she believed would fairly resolve her claims. In addition, the panels' failure to record all the proceedings as required by the FINRA rules and the ex parte conversation between Arbitrator Smith and counsel for UBS further undermined the integrity of the proceedings. For all these reasons, the Petition to Vacate the Arbitration Award was granted.

Distinction between Independent Contractor and Employee Under the Arbitration Act

New Prime, Inc. vs. Oliveira, 586 U.S. ____(U.S. Sup. Ct., January 15, 2019)

In this case the Supreme Court reviewed an exception to the Federal Arbitration Act ("FAA"). The FAA requires courts to enforce private arbitration agreements with certain exceptions. One exception to the act is the exclusion under Section 1 which sets forth that "nothing herein" may be used to compel arbitration in disputes involving the "contracts of employment" of certain transportation workers. 9 U.S.C. §1. That qualification raised two questions to be answered by the Supreme Court in this case. The first questions was: when a contract delegates questions of arbitrability to an arbitrator, must a court leave disputes over the application of Section 1's exception for the arbitrator to resolve? The second question was: does the term "contracts of employment" refer only to contracts between employers and employees, or does it also reach contracts with independent contractors? Courts across the country have disagreed on the answers to these questions, therefore the Supreme Court reviewed this case to resolve these issues.

Truck driver Oliveira brought a class action against trucking company New Prime arguing it deprived him and similarly situated drivers of wages under applicable labor laws by classifying them as independent contractors

rather than employees. New Prime is an interstate trucking company and Oliveira works as one of its drivers. On paper, Mr. Oliveira isn't an employee because the parties' contracts label him an independent contractor. When New Prime sought to enforce an arbitration clause in Oliveira's "independent contractor agreement" by moving to compel arbitration under the FAA, Oliveira argued that the FAA did not apply to the dispute. Oliveira cited to FAA Section 1, which excludes from the Act's coverage "contracts of employment of . . . any . . . class of workers engaged in foreign or interstate commerce," a definition he argued covered his independent contractor's agreement.

Ultimately, the district court and the First Circuit sided with Mr. Oliveira. The court of appeals held, first, that in disputes like this a court should resolve whether the parties' contract falls within the Act's control or Section 1's exclusion before invoking the statute's authority to order arbitration. Second, the court of appeals held that Section 1's exclusion of certain "contracts of employment" removes from the Act's coverage not only employer-employee contracts but also contracts involving independent contractors. The lower court held that it lacked authority under the Act to order arbitration. The Supreme Court reasoned that while a court's authority under the Act to compel arbitration may be considerable, it isn't unconditional. The Court determined that if two parties agree to arbitrate future disputes between them and one side later seeks to evade the deal, the Act often requires a court to stay litigation and compel arbitration according to the terms of the parties' agreement. However, the Court reasoned that this authority doesn't extend to all private contracts, no matter how emphatically they may express a preference for arbitration. The Court held that unless a party specifically challenges the validity of the agreement to arbitrate, both sides may be required to take all their disputes, including disputes about the validity of the broader contract, to arbitration.

The Court next examined the statutory framework and concluded that, before a court can enforce a delegation clause, which is an agreement to arbitrate arbitrability disputes, the court must conclude that the contract is governed by the FAA. The court concluded that Oliveira's objection to arbitrability here is an "antecedent statutory inquiry" for a court, not an arbitrator, to make. The Supreme Court ruled that the Section 1 exclusion applies to contracts of employment of both independent contractors and employees. The Court determined that the statutory language "workers" had a broader meaning than exclusively employees. The court further reasoned that at the time of the passage of the FAA in 1925, the term "contract of employment" did not necessarily imply a modern-day legal employment-employee relationship. Rather, a "contract of employment" could include an

independent contractor's agreement to perform work. Therefore, the Court could not enforce the arbitration clause or the delegation clause in Oliveira's independent contractor agreement, because they fell within the Section 1 exclusion. As a result, the Supreme Court held that the applicability of the Section 1 exclusion is an issue for the court to decide, as that section defines which arbitration agreements fall within the scope of the FAA.

The Court then reviewed specifically the questions of: What does the term "contracts of employment" mean? The court reasoned that if it refers only to contracts that reflect an employer-employee relationship, then Section 1's exception is irrelevant and a court is free to order arbitration, just as New Prime suggests. However, if the term also encompasses contracts that require an independent contractor to perform work, then the exception takes hold and a court lacks authority under the Act to order arbitration, as Mr. Oliveira argues. The Court reasoned that at least one recently published law dictionary defines the word "employment" to mean "the relationship between master and servant." Black's Law Dictionary 641 (10th ed. 2014). The Court further reasoned that when Congress enacted the Arbitration Act in 1925, the term "contracts of employment" referred to agreements to perform work. Therefore, the Court held that Mr. Oliveira's agreement with New Prime falls within Section 1's exception and the court of appeals was correct that it lacked authority under the Act to order arbitration, and the judgment was affirmed.

Second Circuit Finds Puffery is Inactionable

Fogel vs. Vega, No. 18-cv-650, 2018 U.S. App. LEXIS 36441 (2d Cir., December 26, 2018)

In this case, the court reviewed statements to determine if the at issue statements were actionable or "immaterial puffery". Defendant Wal-Mart de Mexico ("Wal-Mex") is a subsidiary of Defendant Wal-Mart Stores Inc. ("Wal-Mart") that owns and operates retail stores in Mexico and Central America. There are also several individual defendants who held various roles at Wal-Mex and Wal-Mart. Plaintiff's Second Amended Complaint ("SAC") alleges that beginning in 2003, top executives at Wal-Mex engaged in widespread bribery of various local government officials to secure building permits and other local government approvals to build new stores in Mexico. The New York Times published an extensive article entitled "Wal-Mart Hushed Up a Vast Mexican Bribery Case," which gained widespread public attention. The article indicated that extensive bribery had occurred. The article also suggested that the scheme violated the Foreign Corrupt Practices Act.

Congress later announced an investigation into the allegations of bribery by Wal-Mex officials.

Fogel brought this putative class action in the United States District Court for the Southern District of New York, on behalf of all purchasers of American Depositary Receipts ("ADRs") of Wal-Mex during the relevant time period. Fogel alleges that, as a result of Defendants' scheme and misrepresentations, Wal-Mex ADRs were overvalued during the class period. Fogel, in his SAC, alleges several statements that form the basis of his claims under Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5 and Section 20(a). The district court held that all the identified statements fail to state a claim, because Plaintiff did not sufficiently allege the falsity of the statements, and that Plaintiff has failed to establish that Wal-Mex's statements regarding its internal controls constituted actionable statements of opinion, that is, that they were made with knowledge of their falsity.

In its February 27, 2017 opinion, the district court granted the Defendants' motion to dismiss. The district court dismissed the remaining claims that were not time-barred for failure to state a claim under Section 10(b), Section 20(a), and Rule 10b-5 because Fogel had not adequately pleaded scienter, and he plead insufficient facts to impute scienter to Wal-Mex. The district court also held that Fogel had failed to plead actionable misrepresentations or omissions because all the statements from the Wal-Mex Annual Reports and its website are "inactionable, immaterial puffery," he alleged no facts demonstrating that the statements were false, and Fogel failed to adequately plead scheme liability. The district court also found that because it had concluded that there was no 10b-5 violation, there could be no liability for control persons under Section 20(a). Finally, the district court denied Fogel's motion for leave to amend his complaint. The district court held that a proposed Third Amended Complaint would be futile because it would not remove the time bar for many of the claims, and it also would not change the core of the remainder of the claims. Fogel appealed these determinations.

A plaintiff bringing a private suit under Section 10(b) and Rule 10b-5 must prove "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation." *GAMCO Inv'rs, Inc. v. Vivendi Universal, S.A.,* 838 F.3d 214, 217 (2d Cir. 2016) (quoting *Halliburton Co. v. Erica P. John Fund, Inc.,* 573 U.S. 258, 267 (2014)). The court reasoned that for an alleged misstatement to be "material" under §10b, it "must be sufficiently specific for an investor to reasonably rely on that statement as a guarantee of some concrete fact or outcome." *City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG,* 752 F.3d 173, 185 (2d

Cir. 2014). The Supreme Court has specifically held that "general statements about reputation, integrity, and compliance with ethical norms are inactionable 'puffery,' meaning they are 'too general to cause a reasonable investor to rely upon them.'" *Id.* at 183 (quoting *ECA, Local 134 IBEW Joint Pension Tr. of Chi. v. JP Morgan Chase Co.,* 553 F.3d 187, 206 (2d Cir. 2009)). However, "[t]his is not to say that statements about a company's reputation for integrity or ethical conduct can never give rise to a securities violation." *Ind. Pub. Ret. Sys. v. SAIC, Inc.,* 818 F.3d 85, 98 (2d Cir. 2016). "[F]or example, a company's specific statements that emphasize its reputation for integrity or ethical conduct as central to its financial condition or that are clearly designed to distinguish the company from other specified companies in the same industry" may suffice. *Id.*

Fogel argues that because the statements about Wal-Mex's integrity and ethics were "important" to its "business model," they are not immaterial puffery. The Court disagreed and conclude that the district court was correct in its analysis of these statements. The Court reasoned that Fogel failed to plead the falsity of the statements. Under the heightened pleading standards applied to claims under Rule 10b-5, plaintiffs "must do more than say that the statements . . . were false and misleading; they must demonstrate with specificity why and how that is so." *Rombach v. Chang,* 355 F.3d 164, 174 (2d Cir. 2004). All the identified statements as to the ethics and integrity of Wal-Mex and its supposed compliance with Mexican Securities Laws also fail to support a claim because the Second Amended Complaint does not sufficiently allege the falsity of the statements. Thus, the court concluded that the statements regarding financial performance are not actionable.

Fogel also failed to adequately plead scheme liability. "Scheme liability" derives from subsections (a) and (c) of Rule 10b-5, which prohibit schemes to defraud investors. 17 C.F.R. § 240.10b-5(a), (c). Plaintiff argues that the alleged "multi-year criminal enterprise to bribe government officials to open new stores to drive growth, followed by a cover-up to conceal the criminal activity, is a classic example of a scheme." The court found that Fogel did not allege an actionable scheme. Moreover, Fogel failed to allege a deceptive act, aside from the misstatements he alleges are actionable under 10b-5(b). For that reason, the court affirmed the district court's decision on scheme liability.

The court also reviewed the denial of the motion for leave to amend for an abuse of discretion. *Jones v. N.Y. State Div. of Military & Naval Affairs,* 166 F.3d 45, 49 (2d Cir. 1999). Leave to amend a complaint should be freely given when justice so requires. Fed. R. Civ. P. 15(a). "Where, however, a party does not seek leave to file an amended complaint until after judgment is entered, Rule 15's liberality must be tempered by considerations of finality." *Williams v. Citigroup Inc.,* 659 F.3d 208, 213 (2d Cir. 2011). Furthermore, a district

court may deny leave to amend when such amendment would be futile. *See, e.g., Foman v. Davis,* 371 U.S. 178, 182 (1962); *Elecs. Commc'ns Corp. v. Toshiba Am. Consumer Prods., Inc.,* 129 F.3d 240, 246 (2d Cir. 1997). The court concluded that the district court did not err in refusing to allow Fogel to file a Third Amended Complaint. Fogel failed to allege valid claims in each of his prior complaints. The court noted that a Third Amended Complaint would be futile because it could not remedy the deficiencies of materiality or scheme liability. For the reasons stated above, the district court's decision and resulting judgment were affirmed.

FINRA Award Challenged on Portal Notice Requirements

Lawrence vs. Raymond James Financial Services, Inc., No. 18 Civ. 6590, 2019 U.S. Dist. LEXIS 2337 (S.D.N.Y., January 4, 2019)

This case arises from an arbitration award issued in a dispute between Petitioner Lawrence and Respondent Raymond James Financial Services, Inc. (“RJFS”). Lawrence moved to vacate the arbitration award (the “Award”) rendered in favor of RJFS. RJFS opposed the motion and cross moved to confirm the Award. Lawrence is a former registered representative of RJFS. Lawrence and RJFS executed a Loan Terms Agreement (the “Agreement”). Pursuant to the Agreement, the parties arranged that they would arbitrate disputes concerning the Agreement and that the Financial Industry Regulatory Authority (“FINRA”) rules would govern the enforcement of the terms of the Agreement.

Lawrence’s relationship with RJFS terminated and RJFS filed the underlying arbitration with FINRA. RJFS’s Statement of Claim against Lawrence asserted a breach of contract claim to recover money loaned to Lawrence under the Agreement. According to FINRA rules, FINRA was responsible for serving Lawrence in the arbitration. FINRA § 13301(a) on the service of an associated person states: [T]he Director will serve the Claim Notification Letter on an associated person directly at the person’s residential address or usual place of abode. If service cannot be completed at the person’s residential address or usual place of abode, the Director will serve the Claim Notification Letter on the associated person at the person’s business address. FINRA Regulatory Notice 17-03 further states: FINRA staff will serve the initial statement of claim and a Claim Notification Letter. The Claim Notification Letter provides notice to respondents that they have been named as a party in a statement of claim. The Claim Notification Letter provides information about accessing the Party Portal to obtain a copy of the statement of claim filed by the claimants and information about the arbitration, including

the hearing location selected by the Director and the deadline for filing a statement of answer. If a respondent does not access the Party Portal and view the statement of claim, FINRA staff will contact the respondent and ask if the respondent received the Claim Notification Letter. If the respondent indicates that he or she did not receive the Claim Notification Letter, FINRA staff will offer to serve the Statement of Claim ("SOC") in another manner such as by email or regular mail to afford the respondent an additional opportunity to receive the statement of claim. In this case, FINRA mailed the Claim Notification Letter and SOC to Lawrence's residential address.

Lawrence did not file an answer to the SOC nor otherwise participate in the arbitration. The sole arbitrator rendered an Award against Lawrence and in favor of RJFS for $134,217.63, plus interest and $2,000 in attorneys' fees and costs. Although Lawrence failed to register on the Dispute Resolution Portal (the "DR Portal") pursuant to FINRA Regulatory Notice 17-03, the arbitrator determined that Lawrence had been properly served and was therefore bound by the arbitrator's decision. Lawrence filed a Petition to Vacate and RJFS filed a Cross-Petition to Confirm the Arbitration Award.

The court reasoned that confirmation of an award rendered in a FINRA arbitration "is governed by the Federal Arbitration Act." *Thomas James Assocs., Inc. v. Jameson*, 102 F.3d 60, 65 (2d Cir. 1996). Ordinarily, confirmation of an arbitration decision is "a summary proceeding that merely makes what is already a final arbitration award a judgment of the court." *Citigroup, Inc. v. Abu Dhabi Inv. Auth.*, 776 F.3d 126, 132 (2d Cir. 2015). "A court's review of an arbitration award is . . . severely limited so as not to frustrate the twin goals of arbitration, namely, settling disputes efficiently and avoiding long and expensive litigation." *United Bhd. of Carpenters & Joiners of Am. v. Tappan Zee Constructors, LLC*, 804 F.3d 270, 274-75 (2d Cir. 2015). The party seeking to "vacate an arbitration award has the burden of proof, and the showing required to avoid confirmation is very high." *STMicroelectronics, N.V. v. Credit Suisse Sec. (USA) LLC,* 648 F.3d 68, 74 (2d Cir. 2011).

Lawrence asserts that he had no notice of the arbitration proceedings and was not served with process in accordance with FINRA rules. The court determined that the arbitrator did not exceed his authority in determining that Lawrence received adequate service of process. The court held that FINRA rules empower the arbitrator to rule on the issue of service. FINRA Rule 13413 provides that "the panel has the authority to interpret and determine the applicability of all provisions under the Code. Such interpretations are final and binding upon the parties." *Murray v. UBS Sec., LLC*, No. 12 Civ. 5914, 2014 WL 285093, at 13 (S.D.N.Y. Jan. 27, 2014) ("FINRA Rule 13413 'clearly and unmistakably evinces an intent to submit any disputes over the interpretation of the Code rules to arbitration.'") (citing *Alliance Bernstein Inv.*

Research and Mgmt., Inc., 445 F.3d 121, 127 (2d Cir. 2006)). The court held that Rule 13413, therefore, gives the arbitrator power to interpret and determine the applicability of FINRA Rules 13300, 13301 and 13302 governing service. The court reasoned that the parties consented to FINRA rules, which empower the arbitrator to make determinations regarding the sufficiency of service. Therefore, the arbitrator acted within the scope of his authority in determining that Lawrence was properly served.

The court found that in the Award, the arbitrator clearly reasoned that Lawrence had received valid notice of the arbitration proceedings. The arbitrator found that Lawrence had been served by regular mail the Claim Notification letter which advised him of the requirement to use the online DR Portal and cautioned him that failure to do so would prevent him from submitting pleadings, selecting arbitrators and receiving notifications about the arbitration. FINRA also sent Lawrence another letter advising him that registering for the DR Portal was mandatory and failure to register would be indicated in the final Award. There is no requirement under Regulatory Notice 17-03 or the FINRA rules that the documents must be sent to a party via certified mail. The court held that regardless of whether regular mail constitutes enough service of process, Lawrence was on notice of the arbitration proceedings. The court found that Lawrence failed to satisfy the "very high" burden to vacate an arbitration award. For the foregoing reasons, Lawrence's Petition to Vacate was denied and RJFS's Petition to Confirm was granted.