

# Securities Litigation Results in Win for Broker and Clarifies Law in the Eighth Circuit



**Devin Bates**  
dbates@mwlaw.com  
(501) 688.8864

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Through an investment bank (acting as broker), clients invested in Reverse Convertible Notes (RCNs). RCNs are a complex “structured financial product” that is sometimes championed as a high-yield, short-term investment promising above-market interest payments but is nonetheless viewed as “perhaps the riskiest” structured financial product available. Of primary importance in this dispute was the Client Account Agreement (the “Agreement”), which governed the relationship between the broker and each client, and its legal effect once signed by the clients. This was in large part because the Agreement provided that the securities transactions for, or in each client’s name, would be subject to the rules and regulations of, among other applicable authorities, the Financial Industry Regulatory Authority (FINRA). The clients sued the broker for breach of contract, alleging that the broker breached its duty to comply with FINRA rules and its duty to know the clients’ investment profiles.

Two different lawsuits culminated last week in an opinion announced by the United States Court of Appeals for the Eighth Circuit following an appeal. Distinguishing a similar case from the Fourth Circuit, the Eighth Circuit concluded that:

- The Agreement language controlled as an unambiguous contract generally would;
- By referencing FINRA, the Agreement did not create a duty of full FINRA compliance; and
- There was no general “know your customer” duty implied in the Agreement.

Finding no duty, the Eighth Circuit found in favor of the broker and affirmed the broker’s victory at the lower court. This blog post will highlight several takeaways from this opinion.

**Careful Wording of Agreements.** Because the contractual language of this particular Agreement was upheld and enforced, its wording provides a helpful example for brokers to review when considering how to word similar agreements. Here, the Court found that the language in the Agreement that all transactions in each client’s account “shall be *subject* to all applicable laws and the rules and regulations of all federal, state and self-regulatory agencies, including, but not limited to . . . FINRA” (emphasis added) did not create a contractual duty for the broker. Rather, that language was “an acknowledgment by the clients that [the broker would] comply with FINRA rules.” One way to read this case is that by following this wording or otherwise using language that is unambiguous, a broker can avoid trouble in the Eighth Circuit or in a state such as Minnesota where the law gives unambiguous words in a contract their plain and ordinary meaning. Further, because the Eighth Circuit held that there was no general “know your customer” duty implied in the Agreement, this opinion sends an important message to people looking to stir up securities litigation: if the duty is not expressly spelled out in the contract, the Eighth Circuit is probably not going to imply one.

**Shifting Law to Watch.** FINRA does not create a private right of action whereby aggrieved investors could sue their broker for every alleged FINRA violation. Because of this legal reality, investors embroiled in securities litigation may seek to show that even though FINRA does not create such a form of legal relief, a broker has promised its customers FINRA compliance in a way that opens itself to litigation. This theory has gained some traction outside of the Eighth Circuit. In this case, the clients had relied in part on other cases from courts nationwide which might seek to show why the broker in this case had such a duty. The Eighth Circuit specifically distinguished one such case, *Interactive Brokers LLC v. Saroop*, 969 F.3d 438 (4th Cir. 2020). There, the Fourth Circuit interpreted a contract with similar “subject to” language in the context of an arbitration award and found that the contract “could well be read as incorporating the FINRA rules, making a violation of the rules a breach of the parties’ contracts.” However, the Eighth Circuit found that holding unpersuasive, noting, “[t]hat opinion stands only for the proposition that the arbitration panel’s reading of the contract as incorporating FINRA rules was not a manifest disregard of the law.” Thus, the cases were different enough procedurally that this does not expressly establish a circuit split. However, anytime that one circuit meaningfully distinguishes the decision of another as implicated by a litigious federal regulatory system like FINRA, securities lawyers should take note of the decision. Even though these cases sometimes hinge on state contract law, a rule made in one case can be applied to arguments made nationwide.

**Knocking Out Securities Litigation on Technicalities and Preclusion Grounds.** Often times when complex securities litigation arises, there are a number of mechanisms through which the case may be thrown out. This case presents a quintessential example. Typically, an aggrieved investor pursues individual claims against a broker through FINRA arbitration. Prior to this case, the investors brought another one, individually and as a putative class action, all based on the alleged unsuitability of the RCNs. The broker successfully argued that it was precluded by the Securities Litigation Uniform Standards Act (“SLUSA”), 15 U.S.C. § 78bb(f). Then, the investors filed, individually and for a purported class, a second lawsuit alleging that the broker breached a written contract by selling RCNs to inexperienced customers. The Eighth Circuit decision detailed here was the final nail in the coffin for this second lawsuit, as the broker successfully proved that there was no legal duty. These are just a few of the defensive weapons in a securities lawyer’s arsenal of technicalities and threshold arguments that can be used to throw out such litigation before it ever reaches trial. In this case, skilled commercial litigators saved the day for this investment bank and its brokers.

Case reference: *Luis v. RBC Capital Markets, LLC*, No. 19-2706 (8th Cir Dec. 28, 2020).