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Securities and Corporate Governance Litigation Group ALERT

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FIRST CIRCUIT REJECTS SEC POSITION THAT BROKER MAY BE LIABLE UNDER 10b-5 FOR PROVIDING OFFERING MATERIALS CONTAINING MISREPRESENTATIONS

In a decision of "first impression," the First Circuit found that a broker-dealer is not liable under Section 10(b) of the Securities Exchange Act or Rule 10b-5 for misrepresentations set forth in offering materials that the broker-dealer provided to investors but did not prepare. SEC v. Tamone, Case no. 07-1384, 2010 WL 796996 (C.A. 1, March 10, 2010). The SEC argued that the broker-dealer was liable under Rule 10b-5 for using a mutual fund's offering materials, which contained misrepresentations, in selling the mutual fund to investors. Rejecting numerous legal and policy arguments set forth by the Commission, the court found that the broker-dealer did not "make" any untrue statement within the meaning of Rule 10b-5. In reaching its conclusion, the court distinguished the language of Rule 10b-5 ("to make any untrue statement of material fact") with language of Section 17(a)(2) of the Securities Exchange Act ("to obtain money or property by means of any untrue statements of a material fact"). Consequently, the decision provides ground for seeking the dismissal of an investor action under Rule 10b-5. The decision, however, does not bar an enforcement action by the SEC under Section 17. (*Note: investors cannot bring claims under Section 17 because the federal courts have refused to imply a private cause of action.*)

HIGH-LEVEL STATISTICAL STUDY PROVIDES GUIDANCE ON ARBITRATOR SELECTION

Professors from three prestigious law schools recently published a thorough statistical study concerning arbitrators in securities arbitrations. S. Choi, J. Fisch & A. Pritchard, "Attorneys as Arbitrators," 39 Journal of Legal Studies, 3146 (Jan. 2010). While the focus of the study was the impact of attorneys acting as arbitrators, the data and analysis of the study also concern the general population of arbitrators. The authors analyzed 422 randomly selected arbitrators and their 6,724 arbitration awards issued during 1992 through 2006. The findings and observations of the authors certainly add to the discussion regarding compulsory securities arbitration. For attorneys representing clients in FINRA arbitrations, however, certain findings should be considered in evaluating and selecting arbitrators. Those observations include:

- Arbitrators who make political contributions to Democratic Party candidates are significantly more generous in awarding damages. (*Note: practitioners can find information concerning political contributions through various websites.*)
- Arbitrators who act as attorneys for brokerage firms tend to side with brokerage firms, but attorneys who represent investors are not more generous in awarding damages than other arbitrators.
- Interestingly, the observations set forth in the two points above do not necessarily apply to cases concerning substantial damages. It appears that arbitrators' awards are less prone to reflect the identified biases when significant damages are at issue.
- First-time or inexperienced arbitrators are less likely to award large damage amounts than more experienced arbitrators.
- Frequent users of securities arbitration (such as brokerage firms and attorneys) tend to experience more favorable awards than parties and attorneys who appear infrequently before arbitration panels. The authors hypothesize that the reason for this disparity is that arbitrators tend to favor frequent users in order to make themselves more attractive and likely to be selected as an arbitrator. (*Note: this bias can work in favor of a well-known, frequent user claimant's counsel as well as, brokerage firms and their counsel.*)

In completing the list selection process for FINRA arbitrators, each of these observations should not replace counsel's experience with potential arbitrators, counsel's analysis of previous awards of potential arbitrators or other reliable information. When other such dependable information is not available, these findings should be considered and may be particularly useful.

Honigman has an exceptional record in representing major broker-dealers in class actions/mass actions, customer arbitrations, and industry disputes, as well as some of the leading broker-dealer cases in the Sixth Circuit.

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