

Insights

U.S. COVID-19: “THE SHOW MUST GO ON!” COURT REJECTS CHALLENGE TO FINRA’S VIRTUAL-HEARING PROCEDURE

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As courts around the country navigate how to handle proceedings during the COVID-19 pandemic, arbitral tribunals face the same struggles. The Financial Industry Regulatory Authority (“FINRA”) operates the largest arbitral forum for securities disputes and is continuously updating its procedures for holding hearings during the pandemic. FINRA’s current policy postpones all in-person hearings through October 2, and provides for virtual evidentiary hearings if the parties consent or the panel of arbitrators orders it. This week, one individual broker sued in federal court, seeking to enjoin FINRA from proceeding with a virtual, evidentiary hearing over his objection. He lost.

In *Legaspy v. FINRA*, No. 1:20-cv-4700 (N.D. Ill.), Carlos Legaspy, a FINRA-registered broker associated with Insight Securities, Inc., sued to enjoin FINRA from holding his hearing virtually. According to Legaspy’s complaint, two of Legaspy’s customers named him and Insight Securities as respondents in the underlying arbitration, seeking over \$2.7 million in damages. The arbitration had been set for an in-person hearing in Boca Raton, Florida, beginning August 17, 2020. In the lead-up up to that date, FINRA announced it was postponing all in-person hearings and notified Legaspy and the other parties to the arbitration that their August 17th hearing date had been postponed. Shortly thereafter, the panel of arbitrators overseeing Legaspy’s arbitration ruled that the August 17th hearing would proceed, but instead of holding the hearing in-person as planned, the hearing would be via Zoom under FINRA’s virtual-hearing procedures. The panel also acknowledged that the hearing would likely not conclude during the days initially allotted for the hearing, which would therefore need to be continued sometime after February 2021. Legaspy objected to proceeding with the original hearing dates on a virtual platform, arguing that the complexity of the case (including the number of fact witnesses, experts, and documents)—along with the fact that the customer-claimants do not speak English and require a translator—rendered the virtual platform unworkable, to his prejudice. Indeed, the parties’ respective witness lists (exchanged 20 days ahead of the first hearing date) identified dozens of witnesses and at least six experts. The panel overruled Legaspy’s objection and indicated its intent to proceed with a virtual hearing on August 17th.

On August 11, 2020, Legaspy filed his complaint and a motion for a temporary restraining order in the U.S. District Court for the Northern District of Illinois seeking only one form of relief: an injunction to stop FINRA's virtual hearing set to begin on August 17th.

Count I of Legaspy's complaint was a claim for breach of contract, alleging that FINRA's Code of Arbitration Procedure does not allow for evidentiary hearings to be held remotely, in contrast to pre-hearing conferences and some expungement hearings, which do allow for remote appearances. According to Legaspy, FINRA's arbitration rules are incorporated into his agreement to arbitrate, and the panel violated FINRA's rules by proceeding with a virtual evidentiary hearing, thereby breaching the contract.

Count II was a claim under the Due Process clause of the Fifth Amendment to the Constitution. Legaspy alleged that FINRA functions as a "state actor" given its relationship to the SEC, which holds some supervisory and regulatory functions over FINRA, a self-regulated entity. Legaspy alleged that an award in favor of the customers would bankrupt Insight, causing it to be undercapitalized and have to cease business, damaging Legaspy's livelihood in turn. He also argued that the parties' procedural right to seek to vacate the arbitration award was no real help because FINRA would consider Insight to be undercapitalized (and therefore required to cease all business) the moment the arbitration award is entered. Legaspy argued that these interests of his are put at risk by a virtual-hearing platform that cannot accommodate the complexity of his case and therefore denies him a meaningful opportunity to be heard.

The day after Legaspy filed his complaint and TRO motion, on August 12, 2020, the court held a telephonic hearing. On August 13th, the court denied the motion.

In its Opinion & Order (ECF No. 14), the court held that Legaspy was not entitled to emergency injunctive relief, and called his constitutional challenge "facially meritless." (The court also expressed doubt that venue was properly laid in the Northern District of Illinois, since "FINRA does not reside here and none of the events or occurrences took place here," but FINRA had not raised a venue challenge.)

First, the court held that Legaspy failed to show that he was likely to succeed on his contract theory because FINRA is not a party to his agreement to the submission agreement (the agreement between the parties to arbitrate the dispute). Further, even if FINRA had been a party, under the Federal Arbitration Act, courts leave arbitration-procedure questions to be decided in the arbitral forum. The court noted FINRA Rule 12409 empowers the panel with the "final and binding" authority to interpret "all provisions under the Code," and found that the "panel did precisely that, concluding that the 'location' for its hearing under Rule 12213(a) will be remote."

The court likewise rejected Legaspy's constitutional theory, holding that the Seventh Circuit "likely would agree with what appears to be the unanimous opinion of the other circuits that FINRA is not a state actor." Legaspy also failed to meet his burden of showing that he would be unable to prevent

a meaningful defense over Zoom. He provided no evidence or plausible arguments on the point. As the court explained:

He thus pits his conjecture against this court's experience holding several remote evidentiary hearings since the pandemic began (once with an interpreter), all of which permitted the parties to air their claims and defenses fully. Remote hearings are admittedly clunkier than in-person hearings but in no way prevent parties from presenting claims or defenses. Moreover, the court sees no reason why the Claimants would fare better than the respondent in a remote hearing. The Claimants will have the burden of proof in the arbitration; if anything, the logistical challenges of a remote hearing is more likely to harm them.

The court sympathized with FINRA, holding that it should not be required to "choose between either holding in-person hearings that exposed" all the parties "to COVID-19, or indefinitely delaying its hearings." The balance of equities further favored the claimants in the arbitration, who should not have to wait another half-year for a hearing on their claims when FINRA is providing a mechanism to hold the hearing as scheduled. Finally, the court faulted Legaspy for waiting to file the action and emergency motion until August 11th when he has known the August 17th hearing would be held virtually since June 25th.

All in all, the court held that Legaspy fell short of meeting the high bar for an injunction, and was especially far from justifying an injunction to a pending arbitration, "which is immensely disfavored." The court's strong rebuke of Legaspy's claims illustrates the uphill battle federal-court litigants will likely face if they attempt to challenge FINRA's ability to order a virtual hearing.

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