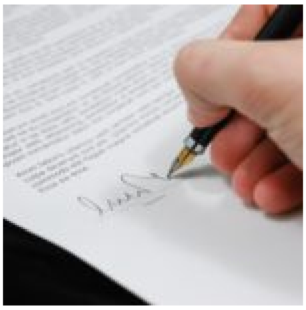


Bayles v. Evans

By [Christopher G. Lazarini]

**A non-signatory is estopped from cherry-picking parts of a contract she finds beneficial, while ignoring those she would prefer not apply, such as an arbitration clause. **Claims of fraud in the inducement of an arbitration clause are for the courts to decide, while claims for fraud in the inducement of a contract generally are for the arbitrators. ***If a court compels a matter to arbitration, it may not weigh in on the merits of the dispute.*

Bayles vs. Evans, Nos. 18-0871 & 18-0876 (W. Va., 4/24/20).

Plaintiff Bayles sued Ameriprise, its broker (Evans), and her step-children, seeking the proceeds of two accounts she claimed Ameriprise improperly paid to the children when Mr. Bayles died. Plaintiff alleged Evans fraudulently induced her to consent to the roll-over of Mr. Bayles' 401(k) account to an IRA account at Ameriprise by telling her Mr. Bayles could not undo his designation of her as beneficiary without her consent.

She also claimed, unbeknownst to her, Mr. Bayles later opened a second IRA account and transferred some assets to it from the original account. He designated Plaintiff as beneficiary on the second account, but changed the designation on the original account to his children. Finally, she claimed Ameriprise sent Mr. Bayles a confirming, negative-consent letter; however, it erroneously indicated he had designated his children as beneficiaries on both accounts when that was not his intent. After Mr. Bayles' death, and absent any corrections by him of the alleged errors, Ameriprise determined to give the proceeds of the accounts to the children.

The trial court ordered arbitration under Ameriprise's Brokerage Account Agreements ("BAA's") and dismissed the case. Bayles appealed on three grounds. First, she argued arbitration should not be required because she was a non-signatory to the BAA's. Second, she argued any contract between Mr. Bayles and Ameriprise was a byproduct of the fraud perpetrated on her, which fraud invalidated the contract. Finally, she argued her claims were beyond the scope of the arbitration clauses in the BAA's.

The Court finds Plaintiff is estopped to deny arbitration, even though she is a non-signatory, because she seeks to enforce her claimed understanding that Mr. Bayles' initial beneficiary designation could not be changed without her consent. The Court concludes this effort to cherry-pick the benefits of the BAA's, including Mr. Bayles' designations of her as beneficiary, estops her from denying arbitration.

The Court also rejects Plaintiff's argument that the BAA's were vitiated by fraud. While fraud may invalidate an arbitration agreement, the Court finds Plaintiff's claims go to the overall existence of a contract. Such a claim is left to the arbitrators, the Court concludes, citing *Prima Paint Corp. v Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) (claims of fraud in the inducement of an arbitration clause are for the courts to decide, while claims for fraud in the inducement of a contract generally are for the arbitrators).

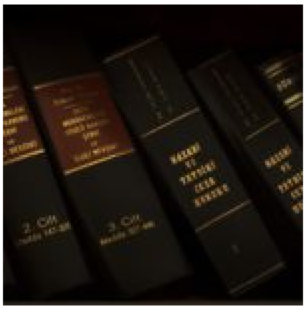
Finally, the Court finds Plaintiff's claims are inextricably intertwined with the Ameriprise accounts and, therefore, fall within the scope of the BAA's arbitration clauses. Defendants also appealed because the trial court's order included findings that Plaintiff was the sole beneficiary of the second IRA account and Ameriprise's confirming letter did not modify that designation. The Court agreed with Defendants that these factual findings should be reversed because the lower court was prohibited from ruling on the merits of Plaintiff's claims.

(C. Lazarini: In SOLA Ref. No. 2016-23-01, we reported on the Court's determination that an arbitration agreement existed between Ameriprise and Mr. Bayles, even though Mr. Bayles had not signed Ameriprise's Brokerage Account Agreement. The Court found Mr. Bayles' signature on the IRA Application, in which he acknowledged having received and read the

Brokerage Account Agreement and that it was governed by an arbitration clause, sufficient to require arbitration. However, the Court remanded on the issues of unconscionability and whether Mrs. Bayles' claims fall within its scope of the clause.)

(SOLA Ref. No. 2020-26-06)

NOTICE: The court decision synopsis published above represents an abbreviated description of the actual decision and is re-printed here for its educational value. The author's effort is to report concisely the substance of the decision or a selected portion of the decision; commentary or analysis is generally reserved for the italicized section at the bottom of the summary. Subscribers to *SAC's Online Litigation Alert (SOLA),* from which this synopsis is excerpted, have immediate access to the full decision, in addition to the synopsis.



Bufkin v. Scottrade, Inc.

By Burton W. Wiand

Claims by a customer relating to the freezing of account assets, their liquidation and turnover to IRS are subject to arbitration under the account agreement.

Bufkin vs. Scottrade, Inc., No. 19-12003 (11th Cir., 4/28/20).

This unpublished decision from the U.S. Court of Appeals for the Eleventh Circuit reviews a decision from the U.S. District Court for the Middle District of Florida that dismissed Michael Edward Bufkin's ("Bufkin") purported "tax" claims against Scottrade, Inc. ("Scottrade") and certain officials and staff of the Internal Revenue Service ("IRS") and the U.S. Department of Treasury (collectively "Appellees"). Bufkin filed suit against Appellees for allegedly selling shares in his Scottrade account, at the request of the IRS, to satisfy an alleged tax liability. He attempted to assert a breach of contract claim against Scottrade and various claims against the IRS and the Department of Treasury (collectively, the "government parties"), including intentional tort claims for violating his "right not to contract" with the IRS to pay taxes and failure to prevent conspiracies under 42 U.S.C. § 1983, and requested administrative sanctions. He also sought a declaration that he is not a "taxpayer."

On appeal, Bufkin argued that the district court erred by: (1) denying his motion to strike the magistrate judge's order staying discovery; (2) granting the government parties' motion to dismiss his complaint; (3) granting Scottrade's motion to compel arbitration; and (4) permitting the clerk to sign and enter judgments against him. The government parties moved for sanctions against Bufkin under Fed. R. App. P. 38. For the reasons below, the Eleventh Circuit affirmed the district court orders and granted the government parties' motion for sanctions.

First, the Eleventh Circuit disagreed with Bufkin's contention that the magistrate judge lacked authority to resolve pre-trial discovery matters. Citing to 28 U.S.C. § 636(b)(1)(A), the Eleventh Circuit determined that the district court was well within its discretion to refer discovery disputes to the magistrate judge. It also concluded that discovery was appropriately stayed given the likely meritorious motions filed by the Appellees against Bufkin.

Second, the Eleventh Circuit affirmed the district court's dismissal of Bufkin's claims against the government parties, concluding that the district court lacked subject matter jurisdiction over them in their official capacities under the sovereign immunity doctrine. It further concluded that the district court lacked personal jurisdiction over Bufkin's claims against the government parties in their individual capacities, because Bufkin failed to properly serve them under either federal or Florida law. Lastly, the Eleventh Circuit agreed with the district court that Bufkin failed to state a claim under Fed. R. Civ. P. 12(b)(6), thereby rejecting Bufkin's "tax protest" arguments challenging the general applicability of tax liability.

Third, the Eleventh Circuit agreed with the district court in granting Scottrade's motion to compel arbitration. The Eleventh Circuit determined that Bufkin's claims against Scottrade are arbitrable breach-of-contract claims and such claims are distinct and severable from his claims against the government parties. As such, the district court did not err in requiring Bufkin to arbitrate his claims against Scottrade separately in arbitration. Fourth, the Eleventh Circuit determined that the clerk properly signed and entered judgments against Bufkin in accordance with Rule 58(b), which states, in relevant part, that the "clerk must, without awaiting the court's direction, promptly prepare, sign, and enter the judgment when … the court denies all relief." Fed. R. Civ. P. 58(b)(1)(c).

Finally, the Eleventh Circuit granted the government parties' motion for sanctions against Bufkin pursuant to Fed. R. App. P. 38 for filing a frivolous appeal. Bufkin had already been warned in a previous appeal to the Court that his "tax protest" arguments were not only frivolous but also barred by sovereign immunity and thus the Eleventh Circuit determined that Rule 38 sanctions are appropriate.

(B. Wiand) (EIC: Mr. Wiand also covered the decision on appeal in an earlier SOLA summary — see SOLA 2018-39.)

(SOLA Ref. No. 2020-23-01)

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Anatomy of an Explained AAA Award: "Oh, What a Tangled Web We Weave…."

Guest author Harry A. Jacobowitz, Esq., analyzes for us an explained AAA Award featuring the largest damages since 2018 and the Arbitrator's detailed explanation (as requested by the parties) of liability and damages in favor of a hedge fund against its fired portfolio manager. And, while no broker-dealer was held liable, it gave one a media relations black eye.

The explained Award in *Carbon Investment Partners LLC v. Bressler*, AAA ID #01-18-0001-3401 (Oklahoma City, OK, Apr. 30, 2019), came to our attention when a bankruptcy court denied the respondent a discharge of the damage award. It is quite a tale.

Collapse of a Conservative Hedge Fund

Carbon Investment Partners ("Carbon GP") was the general partner of Carbon Master Fund, L.P. ("the Fund"), a hedge fund founded in 2016 that held itself out as conservative and market-neutral, focused on equities in the industrial sector, with an emphasis on capital preservation and a requirement that no more than 10% of invested capital be held in any single investment. Lee A. Bressler was a partner of Carbon GP and a founder and chief investment officer of the Fund. He managed the Fund's investments under the supervision of its chief risk officer, Brandon Bradford. However, the Fund was driven into insolvency by bad investments executed in January and February 2018. Carbon GP and the Fund filed this arbitration against Bressler, alleging that he made unauthorized, unsuitable trades about which he deliberately kept his partners in the dark. Bressler counterclaimed, alleging that the claimants defamed him and owed him indemnification, because his partners did know about the trades and that he made them in the Fund's interest.

Risky Business on the Side

The assertions in this and the next paragraph report the sole Arbitrator's findings in the Award. Carbon opened an account (the "primary account") with broker-dealer Jefferies LLC. Bressler was to conduct all trades in the primary account, which Bradford monitored. However, in 2017, Bressler incurred losses in trades that violated the Fund's conservative mandate. In an effort to insulate its limited partners in the most tax-efficient way possible, the Fund placed the securities from these unauthorized trades in "side pocket" accounts (the "side accounts"), in which only Carbon GP's partners would participate. Instead, Bressler used the side accounts to engage in risky unauthorized trading, including options trading on margin. The end came when he made a series of trades that exceeded the Fund's assets by up to 3,000% and lost it all.

Hiding the Truth

With Jefferies' apparent knowledge and assistance, Bressler insulated his side account trading from Bradford's oversight. When Bressler made gains, he failed to report them and instead pocketed them for his own benefit. He also made a series of other misrepresentations and omissions in order to prevent the Fund and his partners from discovering what he was doing. Later, during the arbitration, Bressler repeatedly disregarded his discovery obligations, "including withholding and spoliating potential sources of evidence," and when he finally turned over his computer, its hard drive had been wiped clean. In response, the Arbitrator imposed sanctions, dismissing Bressler's counterclaims and drawing a negative inference that the spoliated evidence would favor the claimants (although the Arbitrator found the evidence so compelling that he did not rely on the adverse inference).

Damages Awarded

The parties stipulated that the Fund lost $10,150,000 in capital. The Arbitrator also awarded almost $2.4 million for an "alleged negative 'deficiency' balance" created by the trades, and $118,645 as disgorgement of Bressler's compensation, yielding a total compensatory damage award of $12,665,301. The Arbitrator also awarded $2.5 million in punitive damages, $1,333,875 in attorney fees and costs, and $296,753 in pre-judgment interest, plus post-judgment interest. The total amount awarded came to just short of $16.8 million. Bressler was also assessed all forum fees.

*(ed: *A summary of the bankruptcy decision denying discharge of the debt, which was granted on summary judgment, appears in our sister publication,* SAC's Online Litigation Alert *(SOLA 2020-20). Summarizing that decision for* SOLA *led to our retrieving a copy of the Award for SAC's Award Database. **We searched the Award Database and found no Award in an arbitration brought by either Carbon entity against Jefferies. However, we did find news stories about the Award's findings concerning Jefferies' alleged role in Bressler's misconduct, so it did not escape unscathed from this debacle. ***This summary was authored by Harry A. Jacobowitz, the owner and operator of HAJ Research and Writing LLC, a company specializing in researching and writing on legal issues and related subjects. A graduate of the University of Pennsylvania Law School with more than 30 years of*

experience in the legal and legal publishing fields, Mr. Jacobowitz is a former manager of SAC's securities Awards database and currently serves in a consulting capacity to SAC and the Alert. *HAJ Research and Writing LLC is available to perform customized searches of the database for SAC subscribers and others. Customized searches may be ordered by emailing searches@sacarbitration.com. Mr. Jacobowitz and his company may also be reached at harryjacobowitz@optimum.net.)* (SAC Ref. No. 2020-21-03)

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Two New FINRA Awards Reflecting Virtual Hearings, and a Change to the Award Template Reinforcing that ODR Is Now "FINRA Dispute Resolution Services"

By George H. Friedman, SAA Editor-in-Chief

Two new Awards have been posted in FINRA's Arbitration Awards Online that show hearings conducted virtually due to the COVID-19 pandemic. Both also reflect new language *underscoring both the forum's new "Dispute Resolution Services" name and its role as administrator, not adjudicator.*

We reported in SAA 2020-15 (Apr. 22) on *Dominick & Dickerman LLC v. Wunderlich Securities, Inc*., FINRA ID #17-01930 (New York, NY, Apr. 6, 2020), the first FINRA Award in a case including a hearing by videoconference due to the Coronavirus. Recall that the unanimous Award said: "Pursuant to an agreement between counsels, all the hearings, except March 12, were held at the offices of Claimants' counsel in New York City. On the consent of counsel for both sides and the arbitrators, the March 12 hearing was held virtually via Zoom with counsel for Claimants, counsel for Respondents and the arbitrators all being at different locations due to concern with the Coronavirus crisis." We later reported in SAA 2020-17 (May 6) that Wunderlich was challenging the $11.4 million Award in the Southern District of New York, based in part on the Arbitrators being "inattentive" during the Zoom hearing.

Two New Awards…

We've identified two new Awards referencing virtual hearings. *Mehrotra v. Barclays Capital Inc*., FINRA ID# 19-00077 (New York, NY, May 12, 2020), states in an explained decision: "On the consent of counsel for both sides and the arbitrators, the April 21, 2020 hearing was held virtually via Zoom with counsel for Claimant, counsel for Respondent and the arbitrators all being at different locations." *Angelina J. Cuccaro Family Trust v. Raymond James & Associates, Inc.,* FINRA ID# 17-02304 (Hartford, CT, May 12, 2020), uses similar language: "On the consent of counsel for Respondent and the Arbitrators, the May 5, 2020 hearing was held virtually via Zoom due to the COVID-19 crisis" (*ed: the Claimants had settled with RJA, but the case proceeded* ex parte *between RJA and a non-appearing third-party defendant*).

… And a New Award Template Disclaimer

We reported in #15 that what we all knew as the "FINRA Office of Dispute Resolution," would become "FINRA Dispute Resolution Services" on May 4. We also said in #15 that, according to FINRA Executive Vice President and Director of Dispute Resolution Rick Berry, the new DRS moniker will hopefully reflect better to the outside world that his group administers, rather than resolves, disputes — an obvious distinction to those in arbitration practice, but one that can be confusing to others, including investors and even the general media. Mr. Berry also told the *Alert* that we could expect to see a change in the FINRA Award template directed towards reinforcing the concept that party-selected neutrals, not FINRA, are the architects and authors of the Award decision. That change is now evident, as both Awards discussed above bear the DRS name and lead with this notice right after the caption: "Awards are rendered by independent arbitrators who are chosen by the parties to issue final, binding decisions. FINRA makes available an arbitration forum — pursuant to rules approved by the SEC — but has no part in deciding the award."

*(ed: *As we've said before, how many times have we seen headlines, announcing "fines" by FINRA, when a large Award by independent arbitrators was the real subject? **The court case is* Wunderlich Securities Inc. v. Dominick & Dickerman LLC*, No. 1:20-cv-03507 (S.D.N.Y. May 5, 2020). Email us at Help@SACArbitration.com for a copy of the MTV.)* (SAC Ref. No. 2020-19-02)

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Unanimous Eleventh Circuit: Under the FAA, an Award Can Be Modified by a Court for Evident Miscalculation Only If the Mistake Is Clearly Evident on the Face of the Award

By George H. Friedman, SAA Editor-in-Chief

The amount of damages in an arbitration award may only be modified by a federal court if there is a mathematical error in calculating the damage "clearly evident" on the face of the award, a unanimous Eleventh Circuit holds in a case of first impression.

We covered *Mid Atlantic Capital v. Bien*, No. 18-1195 (10th Cir. Apr. 14, 2020), in a "Quick Take" in SAA 2020-16 (Apr. 29), and promised a more thorough analysis in a future *Alert*. The Court reviews on appeal a decision of the District Court of Colorado (SOLA 2018-22) confirming a FINRA Arbitration Award (FINRA ID #15-00333). According to Mid Atlantic, the Arbitrators made a material miscalculation in awarding damages and granted in damages far more than Claimants were asking. Mid Atlantic believes, not unreasonably in the District Court's view, that the Panel assessed the brokerage firm damages equating to a double recovery. The District Court confirmed the Award, but, in doing so, it ordered interest and reassignment of post-Award distributions in a way that displeased the Claimants. Thus, both sides appealed.

A Double Recovery?

According to the Court, Claimants' expert offered the Panel two ways to award damages: one via a net out-of-pocket calculation of losses, yielding $292,411; and the other using market-adjusted damages. Using the latter method of calculation, the expert offered a range, from $484,684 to $618,049. The Arbitrators adopted their own terms for their damage awards ("initial investment loss" and "compensatory") and assessed Mid Atlantic, with pre-Award interest of 8%, the sum of $777,094. To that, the Panel added $118,560 in attorney fees and $26,812.82 in costs. Finally, it directed Claimants to reassign ownership rights in Sonoma Ridge Partners and KBS REIT to Respondent.

District Court Confirms

Immediately post-Award, Claimants were satisfied with the Panel's decision and asked for confirmation. Mid Atlantic claimed the Arbitrators' Award must either be vacated or modified under Federal Arbitration Act ("FAA") section 11 ("evident material miscalculation of figures"). Claimants argued that section 11 only allowed for modification of a "material miscalculation" that was apparent on the face of the Award. The District Court conceded that the Panel was probably wrong, as Mid Atlantic urged, but it also agreed with Claimants that it had no authority to correct an error that required reviewing the merits. It declined, however, to award interest on the attorney fees and costs and ordered Claimants to return any distributions or interest received on the investments since the date of the Award, as part of the reassignment process.

Eleventh Circuit Affirms

The primary issue on appeal was the correct interpretation of section 11. Is it enough that a mistake is "evident" to the court or does the FAA restrict modification to only miscalculations appearing on the face of the Award? The Court deems this an issue of first impression and it carefully examines the "text and context" of the FAA for its answer, referring at length to the "persuasive authority of our sister circuits…. [W]e conclude that Section 11(a) embodies a face-of-the-award limitation." First, the word "miscalculation" connotes concern with a mathematical, not a legal, error. Given that the FAA's purpose is to ensure enforcement of arbitration agreements and awards, the word "evident" must relate to the face of the Award, not to the arbitration record. "The broad construction that Mid Atlantic proposes would transform § 11(a) from an exception to address egregious circumstances into a freewheeling authorization for the courts to dig through the arbitration record in search of significant miscalculations." The miscalculation urged by Mid Atlantic cannot fit the face-of-award criterion.

Award of Interest OK

The Court proceeds somewhat more expeditiously with the Claimants' objections on cross-appeal. First, the Award said nothing about interest, when awarding attorney fees and costs. While Claimants make the argument that Rule 12904(j) awards interest on the whole award, the Court counters that the Arbitrators are free to interpret that requirement and chose to award interest on the investment losses only. As for the post-Award interest rate that is set by federal rule; while it can be altered by specific action by the Arbitrators, the Panel here did not address the issue. Finally, the return of post-Award distributions ordered by the trial court was proper. They are part and parcel of the ownership interests that the Panel ordered reassigned to Mid Atlantic. The District Court's judgment is affirmed in all respects.

*(ed: *While the Court's attention to detail in this 65-page Opinion seems tedious at times, its analysis is painstaking and its conclusions resolve a lot of technical issues that frequently arise in construing arbitrators' intentions. **There is a split in the Circuits on this issue, yet the Court says: "We close our analysis of this matter by recognizing, moreover, that the persuasive authority of our sister circuits has reached a similar conclusion." ***This analysis is adapted from one appearing in our sister SOLA publication — SOLA 2020-17.)* (SAC Ref. No. 2020-18-02)

FINRA Stats, 3/20: First Quarter 2020 Ends with Little Change in Case Volume from Last Year…, But Wait!

In our monthly report on the February 2020 statistics FINRA Dispute Resolution Services (FINRA-DRS) posted at the end of March (see SAA 2020-13), we noted that the case filing statistics were coming in, as they had in 2019, at a steady pace of around 300 per month. We also indicated that intra-industry claims were running high at about 45% of the whole.*

In FINRA-DRS' March report, which issued last week, the intra-industry percentage heightened further, moving up to 48% of the 946 claims filed (vs. 592 in February) in the first quarter. In other words, while customer claims stayed relatively even at 167 new claims submitted in March, intra-industry claims surged about 50% from its norm to 187 new claims! Taken together, the March total added 354 new case filings, so that, at the three-month mark, 14% more customer claims have been filed in 2020 than in 2019 at this point and 33% more intra-industry claims.

Customer Claims – Anything Different?

FINRA-DRS provides information on the top 15 controversy types among the customer cases and the top 15 products or "Security Types" involved in customer arbitrations. We do expect to see margin liquidation claims rise, as a consequence of the Corona Crash that took the Dow from 29,000 to 19,000, before it began a partial recovery. If there were account deficits, we would see broker-dealers pursuing collection actions against customers pretty early in the cycle (although they tend to avoid arbitration in such matters) and, later, we can expect customer-initiated claims against their BDs alleging improper and unnecessary liquidations. March is too soon, however. Among the Controversy Types, one sees little change in the case distribution; a small rise in “Error Charges” and “Execution Error” claims might be discerned. On the product side, though, claims involving “Private Equities” and REITs are moving upwards. Fixed-income claims are down, especially in the Municipal Bond and Municipal Bond Fund sectors, signaling, we believe, a dwindling of fresh Puerto Rico bond cases. There were only 111 such cases in this past quarter versus 270 in 2019’s first quarter.

Industry Claims – Where’s the “Beef”?

What caused the surge in industry cases this past month? Disputes relating to compensation seem to be on the rise and in the category for “Promissory Notes” — collection matters against brokers for employee forgivable loans — the number of new claims blossomed from 52 for the first quarter of 2019 to 91 in the quarter past. While we can expect expungement claims to taper down a bit after the new changes to FINRA’s arbitration rules are approved, no diminution in new cases is apparent from FINRA’s charts. The furloughing of brokers, to the extent that’s a consequence of the Covid-19 crisis, will not necessarily trigger a big hike in note cases, in our view, but we would look, as turmoil and turnover increases, for more wrongful termination, compensation and raiding/recruiting disputes. Again, it’s too early for those claims.

Closed Cases and ATTs

We have been commenting, in past statistical analyses, on the shift in party preference for settlement (or aversion to decisions by arbitrators), especially in the customer sector. Overall, parties opted for an arbitral decision in 16% of the closed cases in 2019. In 2020, that trend continues at 16%, while, on the customer side, it dropped from an anemic 13% of the customer claimant matters in 2019 to 12% in the first quarter. In the first quarter, 1,004 cases closed versus 1,014 YOY, as compared to 2019. In the second quarter, the figures will be distorted by the moratorium on hearings at FINRA. We might expect fewer cases will tally as Closed Cases, as almost none will close by live hearing. Open cases should increase, as parties opt to wait for a hearing — or put off settlement talks during this cool-down period. The pending docket currently stands at 4,781 and had been on a slight decline. Average turnaround times (ATTs) will be useless as a statistical indicator — ATTs for Hearing Decisions and for settled cases will both be adversely affected by the moratorium, so look for the Overall ATT to extend even longer. It's already up 16% from last year (15.6 mos. vs. 13.5 mos.).

*(ed: *We reported in SAA 2020-15 (Apr. 22) that what we all knew as the "FINRA Office of Dispute Resolution," would become "FINRA Dispute Resolution Services," on May 4. We'll report when the change becomes official. **The April stats should be revealing as to any potential Corona Crash case filings.)* (SAC Ref. No. 2020-16-01)