BerkeleyLaw
UNIVERSITY OF CALIFORNIA

Berkeley Center for Law,
Business and the Economy

University of California, Berkeley
School of Law
2850 Telegraph Ave, Suite 500
Berkeley, CA 94705-7220

Ph: 510.642.0532 – Fax: 510.643.7095
E-mail: BCLBE@law.berkeley.edu
http://www.law.berkeley.edu/bclbe.htm

# For Brokerage Firms the Best Defense May Be a Strong Offense, but Fairness Concerns Draw the Attention of FINRA and Other Regulators

By Yakov Moldavskiy, LL.M. Candidate 2015 | October 8, 2014

Recently, several brokerage firms have been accused of countersuing unhappy investors to intimidate them and to stymie their efforts to exercise their right to sue.

In most civil actions, it is acceptable to bring a counter claim. The judiciary even encourages parties to file cross-complaints for the purposes of judicial efficiency and economy. Indeed, if both parties have complaints against each other, then it is usually in everyone's interest to resolve their issues in one trial or arbitration. However, this is not a case when a cross action has a hidden agenda.

It is not a secret that most of brokerage firms require their clients to sign an indemnification agreement or include it as a clause to their general agreements with investors. Moreover, many disputes between investors and brokerage firms, especially those involving private placements, are handled in arbitration under the oversight of the Financial Industry Regulatory Authority (FINRA).

A recent example is the case of Ron Vaerewyck, his wife, and seven other investors who brought their claims to arbitration before FINRA. The respondent is Reef Securities, Inc., a brokerage firm from Richardson, TX. Reef countersued its investors for attorneys' fees alleging the cause of action of indemnification from claimants.

Even though the counterclaim of Reef Securities, Inc. was dismissed with prejudice in Mr. Vaerewyck's case, several other brokerage firms have employed similar tactics and pursued counter actions against investors. The investors in many of these cases have already lost enough money to justify suing the brokerage firms, but these previous losses may also make investors reluctant to pursue a claim where a countersuit by the brokerage firm threatens even more financial risk.

In particular, Berthel, Fisher & Company Financial Services, Inc., a brokerage firm from Marion, Iowa, countersued in two arbitrations in 2013 based on the language of private place memoranda signed by investors. Berthel has a long list of arbitrations and "regulatory events," which are administrative actions brought either by FINRA or other regulatory agencies against firms for alleged violations of professional rules. Yet, Berthel claimed that it was entitled to recover legal fees and other compensation because "the investors had lied when they signed a document saying that they were sophisticated and understood the product." Moreover, the brokerage firm alleged that investors had the intent to trick it. Berthel won those two arbitrations against 32 investors last year.

University of California, Berkeley
School of Law
2850 Telegraph Ave, Suite 500
Berkeley, CA 94705-7220

Ph: 510.642.0532 – Fax: 510.643.7095
E-mail: BCLBE@law.berkeley.edu
http://www.law.berkeley.edu/bclbe.htm

The intimidating practice of countersuing investors on a basis of the language in these indemnification agreements is not believed to be widespread at this time, but there may be a growing trend of the practice. According to the White Law Group in Chicago, there are approximately 13 cases in arbitration before FINRA where investors have been countersued for breaching the indemnification clauses in their investor agreements. This is not a precise number of intimidation-oriented counter suits because it does not account for settled disputes; however, even this small number of cases serves as a wake-up call for lawyers who represent investors. "Every brokerage firm out there would do it if they thought they could get away with it," said Michael D. Kennedy, a lawyer who represents Mr. Vaerewyck and the other investors in the above-mentioned case.

Despite these recent outcomes, which may be disturbing to many investors, Michelle Ong, a spokeswoman at FINRA, commented that "[T]he use of any clause or tactic designed to intimidate or keep a customer from exercising his/her right to proceed in arbitration would violate Finra conduct rules and we may investigate the use accordingly."