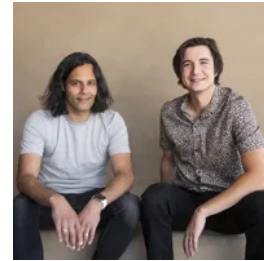


Robinhood allegedly implied a fiduciary duty to novice investors in the marketing of its 'game-like' trading app, even though it's a FINRA-regulated broker-dealer, new class action charges

Three Florida firms sue claiming (IPO bound, Bloomberg reports) Robinhood allegedly failed to direct self-directed investors -- a claim that is both legally shaky, and potentially serious, experts say.

November 16, 2020 — 11:54 PM by Oisin Breen

Brooke's Note: There are lots of things you can disclaim but still get sued over. Ski resort operators and tobacco companies know this. But does that mean a broker who claims no due care to investors can be sued when it shows that it really means it? Lawyers are willing to test that unlikely theory on Robinhood. The good news for the Silicon Valley wunderkind is that the law is pretty decidedly on its side. The bad news is that some jurors might perceive it as an arrogant firm that deserves to turn over its riches to the poor saps who lost a pile of money trading Hertz stock over its platform. If Robinhood loses, the other bad news is it may have to build safeguards against neophyte traders doing unsafe trades. The expense might end its fairytale run of charging zero and making a pile of revenues, anyway, off order flow.



Baiju Bhatt (left) and Vladimir Tenev (right) founded Robinhood in 2013. Now the firm's DIY model is challenged by a suit alleging its duty of care is not just skin deep.



0 Comments

Robinhood investors are supposed to be self-directed, but novice investors might be getting a different message from the marketing of its casino-style trading app that implies a fiduciary duty, according to a new class action that is drawing both hoots and hurrahs from legal experts.

The suit by three Florida firms accuses the Menlo Park, Calif, freebie online broker of "negligence" and a "breach of fiduciary duty" -- even though Robinhood insists it does not have fiduciary relationships with traders through its application.

"There's definitely irony in someone using a free DIY platform like Robinhood, then claiming they didn't receive enough guidance," says Ari Sonneberg, partner and chief marketing officer at Boston-based Wagner Law Group, via email.

Specifically, plaintiff Shterna Pinchasov claims Robinhood should have alerted him about a trading halt on Hertz Corp. stock this past March as the company slid into a pandemic related bankruptcy. The failure to do so caused a "significant loss of money."

"Robinhood assumed a duty to these customers, which it failed to abide by, and doesn't hide the fact that it targets unsophisticated investors," asserted lead attorney Michael Citron, founder and managing partner of Mac Legal in comments provided to [FinLedger](#).

"That's their business model ... But where is the liability?"

Igor Hernandez, attorney at Cornish Hernandez Gonzalez and Ely Levy, partner at Levy & Partners, have joined Citron representing Robinhood investors.

Neither Robinhood nor the plaintiff's lawyers responded to a request for comment.



Michael Citron: [Robinhood] doesn't hide the fact that it targets unsophisticated investors.

Neither Robinhood nor the plaintiff's lawyers responded to a request for comment.

The millennial brokerage also declined to respond to a request from Bloomberg for the article it published Nov. 17 that says the company is seeking out banking counsel for a [prospective IPO in early 2021](#). Robinhood raised \$460 million in September at a valuation of \$11.7 billion.

The fine print

Robinhood has grown meteorically since its 2013 founding, in large part by attracting millennials with no fee trading, no account minimums and its game-like interface. Its 13 million users are, on average, 31 years old. See: [With Robinhood pacing the new norm, Interactive Brokers outpaces Schwab in race to give RIAs free fractional-share trades](#)

"It is so convenient to open and fund an account on your phone and immediately start trading. Word-of-mouth buzz, plus the impacts and reach of social media during the pandemic drove [a growth] frenzy, combined with a fast moving, upward market," says Tim Welsh, president of Larkspur, Calif., consultancy Nexus Strategy, via email.

The firm handles an estimated [\\$40 billion](#) in client assets, and it reaped [\\$271 million](#) in revenues in the first half of this year alone.

Deep pockets make it a ready target for plaintiff's law firms, but Robinhood has putative legal immunity because it's a broker-dealer regulated by the Financial Industry Regulatory Authority (FINRA), says Bill Singer, attorney and writer of the [Broke and Broker blog](#), via email.

"FINRA broker-dealers are *not* RIAs and have, as a result, no ethical, legal, or regulatory obligation to provide real-time monitoring of a customer's portfolio." Robinhood does not file an SEC ADV.

"They are no more responsible to a novice investor than a casino would be to a novice gambler," Sonneberg agrees.

Robinhood dispenses investment services with a duty of care on par with a roulette croupier, says Welsh.



Ari Sonneberg says Robinhood's business model may be jeopardized by the class action.



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"[It's not] a full service experience, just a chance to make a quick few dollars trading Zoom and Tesla. These types of investors don't prioritize service, or execution quality because if they did, they would

never use Robinhood."

Implied duty

But plaintiff's lawyers are basing their case on Robinhood's own marketing and branding, which implies a fiduciary duty it has failed to uphold.

Robinhood takes a fiduciary role because it describes itself as a "teacher," says it is usable by "less knowledgeable traders," and claims it will help investors traverse the "daunting ... and complex system of regulation, financial institutions and assets," the suit asserts.

The irony of the lawsuit is that Florida lawyers believe Robinhood's perceived brashness can be used against it, notes Welsh.

"Robinhood is just an easier target because of its maverick status and arrogant positioning," he explains.

"The Schwabs, E*Trades, Fidelitys and TD Ameritrades have been at this for decades, and have much better operating agreements, contracts and account forms that protect them and is a much bigger mountain to climb for a sue-happy law firm."



Tim Welsh: Robinhood is just an easier target because of its maverick status and arrogant positioning.

Perceived conflicts

Robinhood's image problems go beyond casino-style trading.



Manish Khatta: No matter how cool the big brokers think they are becoming they still have antiquated policies.

It makes money off a practice that is legal, but many observers see as quasi-ethical, at best, because it can introduce perceived conflicts of interest.

Pioneered by Wall Street mega-fraudster [Bernie Madoff](#), Robinhood makes money based on "order flow" to market makers that actually execute the trades.

"Payment for order flow is a method of transferring some of the trading profits from market making to the brokers that route customer orders to specialists for execution," according to a Securities and Exchange Commission (SEC) [study of the practice](#).

"Robinhood will do the minimum sufficient thing for free users, and the most useful things for its paid users ...[its] paying clients are Citadel and other market makers," says Lex Sokolin, a global co-head for financial technology at New York-based software firm ConsenSys, via email.

Any legal obligation placed on Robinhood to warn investors not to execute trades would, it follows, not only cost money to implement and ramp up compliance costs, but also possibly reduce its primary revenue stream.

"A duty to warn investors of a T1 [trading] halt would be the tip of the iceberg of endless possibilities of events that Robinhood would have to protect newbie customers from," says Sonneberg.

"Under that theory, it would be very difficult for Robinhood to make money."

A T1 halt refers to when trades of a company's stock are halted because of the pending release of news likely to lead to abnormal volatility. The suit alleges that Robinhood failed to notify the plaintiff of such a halt, and that it was duty bound to do so.

Times change

The class action suit does not disclose precisely how much Pinchasov lost, but he's seeking a minimum of

The class action suit does not disclose precisely how much it has lost, but he is seeking a minimum of \$30,000.

The plaintiff also claims to be part of a class of investors negatively impacted by Robinhood's failure to notify them over T1 trading halts.

Overall, this class of investors could be owed damages "easily" in excess of \$5 million, according to the suit.

Retail trades make-up 25% of market activity, up from 10% in 2019, according to [Bloomberg](#).

"There may come a day when the law does impose a fiduciary duty on a mere facilitator of a securities transaction," says Sonneberg.

"[If] a court did find [it] owes a higher duty of care to novice investors, it would probably mean the end for Robinhood," he adds.



Lex Sokolin: In the case of Robinhood, the paying clients are Citadel and other market makers

Too cool?

Indeed, its success among a younger cohort is its biggest strength, because its users adopt the brand as much as they do its services, says Sokolin.

"Robinhood's biggest differentiator is that it's still a cool application that's simply designed, where you can trade on your phone, and also flip into crypto assets. It's their brand as status symbol. Schwab is an adult brand. Robinhood is a cool one."

"No matter how cool the big brokers think they are becoming they still have antiquated policies," adds Manish Khatta, president and CIO of Miami, Fla.-based Potomac Fund Management,

"Just last week a major TAMP that self-custodies required us to get a medallion signature guarantee to transfer an account. Imagine making this request to Robinhood type customer with a straight face?"

"[Robinhood investors] just want the app to work without ever having to speak to another human being."

That's been problematic as well.



Bill Singer: The Plaintiff's surplusage makes for good reading but not [such] good law.

Tragic consequences

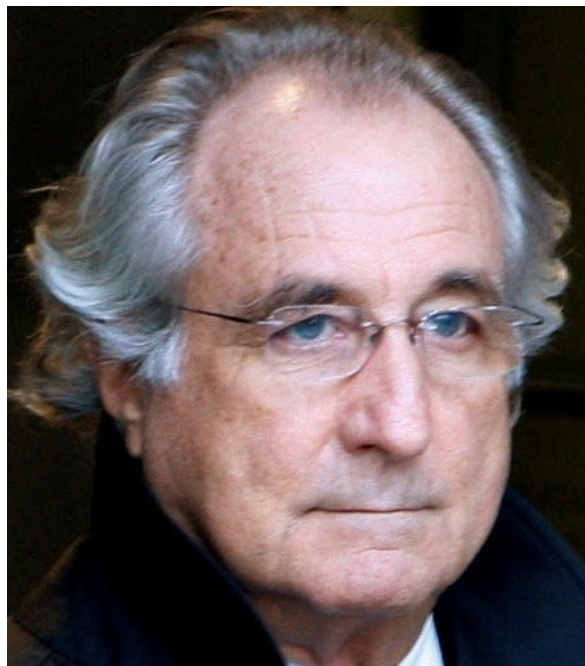
Robinhood is facing another [class action out of California](#) that claims inexperienced investors were locked out of the "game-like interface" during periods of high trading volume this past March.

Investors were unable to buy, sell or trade on the Robinhood app due to [ill-timed outages](#).

"The outages on March 2 and 3 were particularly devastating for Plaintiffs and the Class as the Dow Jones Industrial Average rose 5.1% during that time. Meanwhile, Robinhood users were locked out of their accounts and unable to access their funds or make trades," the suit alleges.

On March 9, the site crashed again during the largest plunge in the Dow Jones Industrial Average in history, it states.

"This will likely prove a more viable avenue of attack," says Singer.



"The inability to access an account in a fast moving market is a far more valid cause of action than to complain that the firm should have educated me about trading before I was allowed to trade."




Bernie Madoff pioneered the practice of payment for order-flow.

Since the initial outages in March, Robinhood's website and app have gone dark 47 times, the lawsuit notes, quoting *The New York Times*.

Its inability to handle trading surges "amount to negligence, breach of contract and fiduciary duties, and violations of FINRA regulations, the plaintiffs allege.

"Unfortunately for many Americans, losing investment and retirement funds or accruing colossal debt is not a game, and the consequences have been tragic," the lawsuit reads.

 No people referenced

 FINRA | Robinhood



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