

Northern District of California: Plaintiff Sufficiently Alleged That an Online Broker's "Significant" Receipt of Certain Payments Was an Indirect Commission Fee (Securities Law Alert)

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On October 13, 2022, the Northern District of California granted in part and denied in part dismissal of a putative securities fraud class action alleging that an online broker violated Section 10(b) by omitting payment for order flow ("PFOF")^[1] from its FAQ webpage discussion of the company's revenue sources and made false and misleading representations that its platform was commission free, when it in fact was not. *In re Robinhood Order Flow Litig.*, 2022 WL 9765563 (N.D. Cal. 2022) (Rogers, J.). The court held that plaintiff adequately pleaded that the broker made fraudulently misleading statements by omitting PFOF as a revenue source and by stating that it was a commission-free platform.

Plaintiff's Allegations

The broker ran a mobile app and website that allowed users to engage in "self-directed securities brokerage services." Among other things, plaintiff challenged the broker's omission of PFOF from descriptions of its revenue sources on its FAQ webpage. Plaintiff claimed that this omission was misleading because PFOF was a large revenue source for the broker. Plaintiff also challenged the broker's representations that its platform provided "commission free" trading. Plaintiff alleged that the broker's receipt of PFOF served as an indirect commission fee that it passed on to users.

Broker's Failure to Disclose PFOF in its FAQ Response on Revenue Was Actionable

In challenging the broker's omission of PFOF from descriptions of its revenue sources on its FAQ webpage, plaintiff alleged that the omission was misleading because PFOF was a large source of revenue for the broker. The broker argued that the omission was not actionable because it had publicly disclosed its receipt of PFOF through various means, including on other parts of its websites, in customer agreements and in trade confirmations, and because the information was widely reported in the news. The court rejected the broker's argument, stating that by suggesting that it was answering "How [our company] Makes Money" on its FAQ webpage, it "was under a duty to ensure its disclosures on that page were complete, accurate, and not misleading." The court determined that the omission was actionable because plaintiff sufficiently alleged that the omission caused its disclosures to be "incomplete, false and misleading."

Plaintiff Sufficiently Alleged That Broker’s Commission-Free Representation Was False and Misleading

Plaintiff also alleged that the broker’s description of its platform as “commission free” was false and misleading because its customers received inferior execution prices compared to its competitors’ customers. Plaintiff alleged that the broker would agree to an inferior execution price for its customers than what principal trading firms were offering in exchange for receiving a higher PFOF rate, which increased the broker’s profits. Plaintiff claimed that these inferior execution prices amounted to an “indirect” commission fee because the PFOF costs were effectively passed on to customers. While the broker argued that its platform was in fact commission free, the court determined that plaintiff sufficiently alleged that the broker’s “significant receipt of PFOF acts as a backdoor or indirect commission fee passed to [its] users,” and the challenged statement was therefore misleading.

[1] PFOF “is the payment or compensation that a brokerage or retail firm receives from principal trading firms directing orders to different market makers.”

Authors and
Contacts

Cheryl Scarboro

Of Counsel

cscarboro@stblaw.com

+1-202-636-5529

Simona Strauss

Senior Counsel

sstrauss@stblaw.com

+1-650-251-5203

David Elbaum

Senior Counsel

david.elbaum@stblaw.com

+1-212-455-2861

