Questions Clients Are Asking About Margin Calls

US Outlook: Top Questions About Margin Calls

1) When can a broker make a margin call? 2
2) Does my broker have the right to suddenly change margin requirements? 4
3) Do I have the right to advance notice of a margin call so that I can pledge more collateral? 5
4) What should I do if I believe my broker made an invalid margin call? 5
5) What obligations does my broker have when liquidating collateral? 6
6) What happens if my broker wants to keep my collateral for itself? 7
7) Does my broker owe me a fiduciary duty? 8
8) What damages can I seek? 10
9) Where can I bring a legal claim against a broker? 10

Market volatility may lead brokers to issue margin calls[1] to investors—i.e., demands of cash or additional collateral from investors trading on margin. Investors may feel such margin calls are unjustified or may disagree with a lender's valuation of collateral in their account. Lenders may also unilaterally seize and liquidate investor collateral to meet the margin call, often with little or no notice to the investor. This memo addresses some of the most pressing questions being asked by investors and other margin traders in this volatile trading environment.

Andrew Rossman
andrewrossman@quinnemanuel.com
Phone: +1 212 849 7282

Christopher Kercher
christopherkercher@quinnemanuel.com
Phone: +1 212 849 7263

* * *

The mechanics of a margin call are relatively simple. Investors borrow money from brokers to leverage market positions and use the investments as collateral. Investors generally agree to maintain a certain "margin" of equity in the account. When investor equity decreases due to changes in collateral value, brokers may issue margin calls to increase the investor's equity to meet the margin requirements.

Most margin agreements spell out when and how margin calls can be made, and if the collateral at issue is liquid enough that value is easily determined. In such cases, disputes are unlikely to arise. But for investors trading on margin using less liquid collateral, a broker's decision to issue a margin call or liquidate an account is often fiercely contested.

This memo analyzes key legal issues surrounding such margin calls and forced liquidations, and provides answers to investors' most pressing questions.

* * *

1) When can a broker make a margin call?

A broker can make a margin call when the debt to collateral value ratio drops below a certain threshold. The New York Stock Exchange and Financial Industry Regulatory Authority ("FINRA") require investors to keep at least 25% of the total value of their securities as margin.[2] But many brokerage firms require more margin, with requirements varying based on the liquidity of collateral.[3]

The circumstances under which a broker can make a margin call are often laid out in the margin agreement signed between the parties.[4] The language, however, can be very general. One typical agreement provides:

> [Investor] further agree[s] that [it] will at all times without notice or demand from [broker] maintain and keep [investor's] account fully margined and protected in accordance with [broker's] requirements and that [broker] will be kept secure by [investor] against fluctuations of the market price of the [securities and commodities] in [investor's] account.
>
> In case of [investor's] failure to maintain with [broker] at all times such margin as [broker] may deem adequate for [broker's] protection, [broker] may, without prior demand or notice to [investor], Sell and/or Purchase such [securities and commodities] as [broker] may consider necessary to fully protect [investor's] account.[5]

This kind of broad language can lead to disputes about how to value the collateral for purposes of a margin call. This is particularly true when the collateral is relatively illiquid, like equity in privately-held companies, structured credit, options, other derivatives or real estate.[6] To determine whether a margin call is valid, courts will first look to the contract and, if that is inconclusive, to the intent of the parties and their course of conduct.[7]

Courts may review the margin call decision for good faith,[8] as a broker is not permitted to intentionally manipulate the value of the collateral so that it can seize it for itself or obtain more collateral than it is entitled to have.[9] Where a failure to act in good faith is alleged, courts look to factors such as:

> **(1)** whether the broker made successive margin calls over a short period of time,[10]
>
> **(2)** whether there was any market justification for such repeated calls,[11]

(3) whether there were third party marks or appraisals or other market indicators showing that the broker undervalued the collateral for the purposes of the margin call,[12]

(4) whether the broker had a conflict of interest in valuing the collateral,[13] and,

(5) the broker's overarching motive in making the margin call.[14]

Where a broker fails to abide by the governing agreement, an investor can challenge the margin call as invalid and potentially obtain damages. While there is relatively limited case law in this area, it still provides helpful guidance:

- In one seminal New York case, an investor sued its broker for making **"grossly excessive" margin calls** in bad faith.[15] The broker sought summary judgment, but the court allowed the case to go to a jury, explaining there was a dispute about whether the **broker made the margin call in bad faith**. The court relied on evidence that the broker made the margin calls not based on an objective valuation of the collateral, but based on "rumors" that the fund may become insolvent and the bank's desire to be "conservative" to protect its own interests. The court observed that the broker's decision to issue multiple, large margin calls in a short period of time further supported a finding of bad faith.

- In another New York case,[16] the court found the investor adequately alleged that **Citibank breached a margin agreement by failing to use good faith in determining the value of the collateral**. There, the investor alleged that "there was no reasonable or good faith basis for continuously reducing asset marks" because there was "little trading" and "very little, if any, downward market movement."[17] The fund also alleged that "other third-party marks . . . came back higher" than Citibank's marks, and that Citibank's margin calls were driven by panic in the market, not by an objective valuation of the collateral.[18]

- A third New York court[19] held that a **broker did <u>not</u> make an improper margin call because it had complied with the parties' agreement**. The agreement stated that "in the event of a challenge by hedge fund to a collateral demand, bank as valuation agent was required to seek four mid-market quotations from market makers and calculate exposure based on the average of those quotations."[20] Because the agreement did not require the bank to independently corroborate those quotations, its alleged failure to do so was not a breach of contract or the covenant of good faith and fair dealing as a matter of law. Thus, where a contract is specific about what a broker has to do to value the collateral, its failure to take additional steps will likely not be deemed a breach of contract or actionable bad faith.

- In a leading bankruptcy case,[21] the court sustained a breach of contract claim alleging that the **broker wrongly triggered the margin call by "misrepresenting the existence of, or overstating the Margin Deficit** and . . . ascribing an overly depressed Market Value to the Subordinated Notes."[22] In addition, the investor alleged "[t]o the extent Lehman maintains that . . . it is a 'generally recognized source' as a market maker with respect to the Subordinated Notes, Lehman failed to . . . act in good faith, without conflicts of interest, and in a commercially reasonable manner."[23]

- In another recent dispute, an investor pledged mortgaged backed securities as collateral, and argued that the **broker was required to obtain a third party appraisal before it could make a margin call** under the margin agreement.[24] The broker argued that it was permitted to liquidate based on its own, unilateral valuation of the collateral as a matter of law. The court rejected the broker's argument and held that the question of whether the broker breached the agreement was for a jury to decide.

In addition to the requirement that the margin call be made in good faith and in accordance with the terms of the margin agreement, there may be additional federal or state level regulations or emergency measures that could affect the obligations brokers, banks and other financial institutions have to their clients.

2) Does my broker have the right to suddenly change margin requirements?

It depends on the contract between the investor and the broker. In some contracts, investors negotiate for a specific margin requirement,[25] as well as the specific terms under which a broker can raise the required margin. If a broker unilaterally alters that agreed-upon margin requirement, it could give rise to a breach of contract claim.[26] Investors may also be able to seek relief if the contract requires the broker to act in a commercially reasonable manner or in good faith and the broker fails to do so in unilaterally raising the margin requirement.[27]

Absent a contractual provision defining the margin requirement, or at least limiting the broker's ability to change it, however, the investor may have less recourse in the face of an unexpected change. One case, for example, quotes the following provision from a margin agreement:

> Customer agrees to maintain at all times such margins in and for Customer's account as [the broker], in its sole and absolute discretion, may from time to time require. Such **margin requirements . . . may be changed by [the broker] at any time** without prior notice to Customer. . . . If at any time Customer's account does not contain the amount of margin and/or premium required by Bradford, Bradford may, at any time, without notice close out Customer's open positions in whole or in part and take any action described in paragraph 9 hereof.[28]

Where the parties have expressly agreed that the broker has the unilateral right to alter margin requirements, courts are more likely to enforce it. Nonetheless, even where the contract gives the broker discretion to change margin requirements, the broker must comply with the covenant of good faith and fair dealing.[29] In particular, "under New York law a claim for arbitrary or irrational exercise of discretion under a contract can be separate and apart from a breach of contract claim."[30] While there is little case law in the specific context of raising margin requirements, these core principles of New York law should apply to these contractual provisions as well.

3) Do I have the right to advance notice of a margin call so that I can pledge more collateral?

Courts will first turn to the terms of the contract as written. If the parties agreed that the broker would give the investor notice of a margin deficit and time to provide more collateral, that provision will almost certainly be enforced. In one case, for example, the contract stated that "[m]arket conditions permitting, [broker] agrees to make reasonable efforts to notify Customer of any margin call or deficiency and allow a Customer a reasonable period of time to cure any margin deficiency."[31] The investor sued the broker for breaching this provision, and the broker moved to dismiss other claims but did not dispute that the breach of contract claim could proceed.[32] Similarly, other courts have enforced obligations requiring the broker to notify the investor of a margin call and give the investor an opportunity to make a cash payment to restore the margin within a certain period of time.[33]

Regardless of what the contract says, however, investors may have a statutory right to notice of the liquidation under the Uniform Commercial Code. In particular, Article 9 Section 611 provides that "a secured party that disposes of collateral . . . shall send [the debtor] a reasonable authenticated notification of disposition" unless "the collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market."[34] That means that for illiquid collateral, a broker may be required to provide notice prior to liquidation unless it can show that the collateral "threatens to decline speedily in value," and its failure to do so may be a violation of the Uniform Commercial Code.[35]

4) What should I do if I believe my broker made an invalid margin call?

<u>Call The Broker</u>

If an investor believes its broker has made an invalid margin call, the investor should speak to them and explain why it believes the call was improper. The broker may be willing to cooperate to maintain the business relationship.

<u>Object In Writing</u>

If the broker is unwilling to withdraw or modify the margin call, then the investor should object in writing (email is fine), stating that the broker has breached the contract. Creating this record is important to refute any argument that the investor has waived her right to challenge the margin call through silence or inaction.[36]

Under New York law, where one party knows the other side has breached a contract and silently continues to perform under the contract anyway, that continuing performance can create a waiver of any resulting breach of contract claim.[37] Following this rule, New York courts have found that posting additional collateral may constitute a waiver of any objection to a margin call.[38] Courts have found waiver even when the investor objected generally by stating "reluctance" to comply with a margin call, or used vague language like expressing "grave concerns" about the request for additional collateral.[39] And while courts will sometimes excuse an investor's failure to object given the "rapid pace" of certain margin calls and how quickly investors must respond,[40] that is not always the case. Thus, while it may not always be practicable to do so, the safest course is to state that a margin call breaches the margin agreement in order to preserve the right to challenge the call in the future.

5) What obligations does my broker have when liquidating collateral?

A broker is obligated to use "commercially reasonable efforts" when liquidating the investor's collateral to satisfy margin requirements.[41] According to New York's Uniform Commercial Code ("UCC"),[42] "[a]fter default, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing."[43] The UCC requires that "[e]very aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable."[44]

The burden of proving whether or not a sale was commercially reasonable depends on the posture of the case. If the broker is suing the investor because the sale of collateral did not fully satisfy the loan amount, the broker "has the burden of establishing that the collection, enforcement, disposition, or acceptance was conducted in accordance with [UCC requirements]."[45] Where an investor sues a broker seeking a surplus, however, courts have held that the investor bears the burden of proving that the disposition was commercially unreasonable.[46]

Where the collateral is liquid, the determination of whether a sale was commercially reasonable is usually straightforward. The UCC states that the sale of a liquid asset will be deemed commercially reasonable if the asset is sold "(1) in the usual manner on any recognized market; (2) at the price current in any recognized market at the time of dispositions; or (3) otherwise in conformity with reasonable commercial practices among deals in the type of property that was the subject of the disposition."[47] This so-called "safe harbor" provision protects brokers who sell assets in an open and efficient market and makes it difficult to later challenge such liquidations.[48]

Where the collateral is illiquid, however, the commercial reasonableness analysis is more complicated. Courts look at both the procedures used to sell the collateral and the ultimate purchase price. Under the UCC, "[t]he fact that a better price could have been obtained by a sale at a different time or in a different method . . . is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner."[49] Nonetheless, "a low price suggests that a court should scrutinize carefully all aspects of a disposition to ensure that each aspect was commercially reasonable."[50] Consequently, at least one treatise has found that price is "the single most important fact in most . . . cases—even in cases where it is not identified as the basis for the court's finding of noncompliance."[51] Thus, while "[t]he primary focus of commercial reasonableness is . . . the procedures employed for sale,"[52] a "marked discrepancy between the sale price and the value of the property will trigger close scrutiny even in the face of procedural propriety."[53]

The commercial reasonableness of a sale is also evaluated based on what would be reasonable for that particular asset of that kind and under the specific market conditions surrounding the sale.[54] Thus, it might be reasonable to reach out only to a few potential buyers for a very specialized asset or one that requires buyers to meet certain qualifications, but unreasonable to advertise more widely-traded collateral to only a small group of buyers. In the end, "[w]hether a sale was commercially unreasonable is, like other questions about 'reasonableness,' a fact-intensive inquiry."[55]

The below cases shed some light on when courts will and will not uphold a sale as commercially reasonable:

- Investor sufficiently alleged that liquidation was **<u>not</u> commercially reasonable** where investor's expert testified that liquidation prices were an average of **13% lower than**

fair market value, and where broker included **only other broker-dealers in the auction**, rather than customers who might be willing to pay a higher price.[56]

- Allegations sufficed to state a claim that sale was **__not__ commercially reasonable** where secured creditor advertised sale too late for bidders to conduct requisite due diligence, subjected debtor to ever-changing requirements before permitting it to participate in auction, imposed unreasonable terms on potential bidders prior to auction, and ultimately rejected debtor's bid in favor of lower bid.[57]

- A debtor successfully stated a claim against its creditor that a sale of artwork was **__not__ commercially reasonable when the creditor accepted a lower price through a private sale**, even though it received a higher bid at auction.[58]

- A sale was **__not__ commercially reasonable** where creditor sold security in a private sale for **18.5% of the original sales price**, without any evidence of fair market value or that it contacted any other prospective buyer.[59]

- The procedures used to sell assets were **commercially reasonable** where "**Goldman Sachs was hired to do the marketing**, and the efforts undertaken by Goldman Sachs were 'consistent in all material respects with actions it has taken in the past in connection with other marketing processes relating to real estate-related companies and equity interests therein.'"[60]

- The sale of diamonds held as collateral was **commercially reasonable** where the broker had **two experts appraise the diamonds** prior to action, reached out to four potential bidders, received bids from **three bidders**, and accepted the highest offer.[61]

If an investor believes the broker could or should have sold collateral at a higher price, there may be recourse if the investor can show that the sale violated the UCC obligation to conduct collateral dispositions in a commercially reasonable manner.

6) What happens if my broker wants to keep my collateral for itself?

A broker generally cannot foreclose on collateral and keep it for itself without the investor's prior consent.[62] It can *purchase* the collateral in some circumstances. The UCC makes this clear: "a secured party, subject to the commercial reasonableness requirement, may purchase its own collateral at a 'public' disposition, but not a 'private' disposition unless it is the kind of property that has a readily identifiable market-based value."[63] Courts read this provision restrictively, and forbid a party from disposing of any collateral to itself at a private sale unless the collateral consists of "widely traded" securities like those bought and sold on a public exchange.[64]

Moreover, a sale is a "public disposition" where "the price is determined after the public has had a meaningful opportunity for competitive bidding. 'Meaningful opportunity' is meant to imply that some form of advertisement or public notice must precede the sale . . . and that the public must have access to the sale."[65] Thus, in order for a sale to qualify as a "public disposition," the secured creditor must invite the general public.[66]

Even if the broker purchases a security interest as part of a "public disposition," courts will still be more skeptical of self-sales given the potential for abuse, as the following cases illuminate:[67]

- Investor had a valid claim that a **self-sale was <u>not</u> commercially reasonable** where investor alleged the "**auctions were an 'elaborate sham'** designed to make it look like [Citi] was marketing the assets when, in reality, [it] had no intention of selling them."[68] The complaint alleged that Citi sold only two assets, and that it "reaped an undeserved benefit of approximately $200 million, measured by the value of the improperly seized collateral from the time of the wrongful seizure to current values."[69]

- Investor had a triable claim that the **self-sale was <u>not</u> commercially reasonable** where Merrill had purchased several securities itself and then **resold the securities to a customer for a 2% profit later the same day**. In addition, before the auction, the customer had given Merrill indications of interest in the securities that it later bought in the resale. According to the court, "[t]his is evidence that Merrill may have improperly diverted profits to itself."[70]

- Investor stated a plausible claim that **self-sale was <u>not</u> commercially reasonable** where creditor was the "**sole bidder** at a sale conducted on only **fourteen days' notice**," creditor "failed to adequately market the property," and "the sale price . . . was substantially less than that at which the parties had previously valued the [d]ebtor's assets and less than the assets would have been appraised for."[71]

- **Self-sale was commercially reasonable** when secured creditors **hired an investment bank** to market the collateral, placed advertisements in newspapers, and **held an auction** four days later, even though the secured creditor was the only bid.[72]

- **Self-sale was commercially reasonable** where contemporaneous evidence showed that **debtor itself did not believe collateral had value** above what was paid, another major creditor was given a chance to bid but never did, and the seller contacted and provided confidential information to "**numerous possible bidders**," none of whom "made a contractually binding offer or even expressed an interest in" the collateral.[73]

It is also an open question whether a broker can ever purchase a security interest in a privately held company or a membership interest in a partnership or limited liability company.[74] The UCC allows a secured party to purchase collateral it holds as security only in a "public" sale, while federal securities laws (as well as the company's bylaws) may limit who the collateral can be offered to. These limitations may pose difficult issues for brokers attempting to run a foreclosure sale for such assets.

7) Does my broker owe me a fiduciary duty?

Whether a broker owes a fiduciary duty to an investor typically turns on whether the investor has a discretionary or non-discretionary account. In a discretionary account, the broker can make trades without the client's prior consent. Given the nature of these accounts, the broker has a fiduciary duty to act in the best interests of the investor, and can be held liable if it breaches that duty in deciding to meet or not meet a margin call.[75]

A non-discretionary trading account, in contrast, is one "in which the customer rather than the broker determines which purchases and sales to make."[76] "A non-discretionary customer by definition keeps control over the account and has full responsibility for trading decisions."[77] Under New York law, "[t]he fiduciary obligation between a broker and customer . . . is limited to the affairs entrusted to the broker, and '[t]he scope of affairs entrusted to a broker is generally limited to the completion of a transaction."[78] Accordingly, there is no general fiduciary duty between a broker and its client for these accounts.[79]

A limited "exception has been recognized whereby courts will find that a fiduciary duty was created where a bank's conduct exceeds the usual creditor-debtor relationship."[80] Courts determine, on a case-by-case basis, whether special circumstances between a borrower and a creditor have created a fiduciary duty.[81] "The existence of a fiduciary relationship is a factual question."[82] In the end, the existence of a fiduciary relationship "cannot be determined 'by recourse to rigid formulas'; rather, 'New York courts typically focus on whether one person has reposed trust or confidence in another who thereby gains a resulting superiority or influence over the first.'"[83]

Whether the court will find a fiduciary duty in any particular case is therefore fairly fact specific, and at times seemingly inconsistent, as the below cases illustrate:

- A broker owed **no fiduciary duty** to an investor in liquidating his assets to meet a margin call because the account in general was a **non-discretionary account and no special circumstances existed**, even though the Futures Account Agreement gave broker the discretion to select what assets to sell to meet a margin call.[84]

- There was sufficient evidence for a jury to find that the broker **owed a fiduciary duty** to an investor where the investor had a **deep and longstanding relationship** with the broker that went **beyond the "regular arms-length debtor-creditor relationship**."[85] The court relied on the fact that the investor had been a member of the credit union for over 30 years, used a broad range of banking and brokerage services, and the broker previously had given notice to the investor of his undersecured position and provided advice on the best way to cure the default.

- A broker owed **no fiduciary duty** to an investor in liquidating an account to meet a margin call where the investor had a non-discretionary account, **even though the investor was a high net-worth individual who received regular and personalized advice** from the broker's top financial analysts and experts, because "the giving of advice is an unexceptional feature of the broker-client relationship."[86] The Court then explained that the "special circumstances" that suffice to transform a broker into a fiduciary—like infirmity or vulnerability or being a 77 year old widow—did not apply to the sophisticated, billionaire investor in that case.

Although most courts will not find that a broker has a fiduciary duty to the investor in general, the broker does have a duty to make a "good faith attempt to dispose of the collateral to the parties' *mutual* 'best advantage,'"[87] Thus, in a liquidation scenario, the broker has a duty not to place its own interests above that of the investor.

8) What damages can I seek?

An investor is typically entitled to recover any actual damages sustained as a result of a broker's breach of a margin agreement, regardless of whether the broker breached the agreement by making an improper margin call or by liquidating assets in a commercially unreasonable manner.

Damages Caused By Improper Margin Call

If a broker wrongfully liquidates collateral after an improper margin call, the investor can seek damages under what's called the "intermediate price rule"—i.e., based on the highest intermediate price of the liquidated securities within a reasonable period after the liquidations.[88] This measure of damages incorporates the duty to mitigate because the investor is not entitled to today's value of the stock that was wrongfully sold, or the highest possible trading price between then and now, but rather the highest value of the stock at the time that the investor could have reasonably repurchased it after the broker wrongfully liquidated its position. "The theory for seeking these damages is that because the margin calls were wrongful the liquidations should never have occurred—rather than that the liquidations should simply have been carried out differently."[89]

In some circumstances, investors may also be entitled to other damages. Investors could theoretically be entitled to bankruptcy costs, for example, if the wrongful margin calls foreseeably drove the investor into bankruptcy.[90] Note that such damages can be hard to prove, however, because a broker can often point to other factors (like lack of liquidity, other financial troubles or failure to meet other short term obligations) that the broker will claim caused the bankruptcy.[91]

Damages Caused By A Commercially Unreasonable Sale Of Collateral

If a broker disposes of collateral in a commercially unreasonable manner, damages are determined by calculating the difference between the value actually received for the collateral and the amount the collateral would have fetched in a commercially reasonable disposition.[92] In the event that the broker sues the investor for a deficiency, there is a presumption that the collateral is worth the full amount of the debt, and it is the broker who bears the burden of proving the value of the collateral used to determine the amount of any shortfall it claims.[93]

9) Where can I bring a legal claim against a broker?

It depends on the margin agreement. If the agreement has a dispute resolution clause, it will likely say where any disputes can be brought. Often, margin agreements require the parties to arbitrate, typically in FINRA arbitration.[94] Such arbitration agreements are likely enforceable, even if the investor alleges that the broker committed fraud.[95] Other margin agreements may specify a court or jurisdiction, and courts will generally enforce such forum selection clauses.[96] If a margin agreement is silent on venue, the investor can likely bring suit wherever venue would be proper, typically in the state or federal courts in which the broker resides.

Further, even if the margin agreement contains an arbitration clause, it may be possible to go to court if emergency relief is sought.[97] Emergency relief is difficult to obtain, however, as the moving party must show that an injunction or temporary restraining order is the only way to preserve the status quo and that the investor will suffer irreparable harm in the absence of emergency relief.[98]

Finally, as we have discussed in detail in another memorandum, the COVID-19 outbreak has led to court closures and limitations on the filing of new lawsuits. Investors and their counsel would therefore be wise to visit court websites for the most current information on how and when to file suit.

* * *

Margin agreements are written by brokers, and so tend to have terms that are highly favorable to them. And by and large, courts are willing to enforce these contracts and give brokers discretion in deciding when to make margin calls, as well as when and how to liquidate investor accounts. But this discretion is not unbridled, and where the broker has wronged the investor by making an improper margin call or selling off the investor's assets at fire-sale prices, courts are willing to step in.

If you have any questions about the issues addressed in this memorandum or otherwise, please do not hesitate to reach out to us.

---

[1] *See* Erik Schatzker and Sridhar Natarajan, *Goldman U-Turn on Hwang Put Bank at Nexus of Margin Call*, Bloomberg (March 28, 2021), *available at https://www.bloomberg.com/news/articles/2021-03-28/goldman-u-turn-on-hwang-put-bank-at-nexus-of-margin-call-mayhem?sref=frV97TwV*.
[2] *See* Securities and Exchange Commission, *Investor Publications, Margin: Borrowing Money to Pay for Stocks* (Apr. 17, 2009) *available at* https://www.sec.gov/reportspubs/investor-publications/investorpubsmarginhtm.html.
[3] *See id.*
[4] *See, e.g.*, *Sher v. Barclays Capital, Inc.*, 35 F. Supp. 3d 725 (D. Md. 2014).
[5] *Geldermann & Co. v. Lane Processing, Inc.*, 527 F.2d 571, 574 (8th Cir. 1975); *see also, e.g.*, *Moss v. J.C. Bradford & Co.*, 446 S.E.2d 799, 804 (N.C. 1994)
[6] *See, e.g.*, *Sher*, 35 F. Supp. 3d at 730 (residential mortgage-backed securities).
[7] *Id.*
[8] *But see, e.g.*, *Integra FX3X Fund, LP. v. Deutsche Bank, AG*, No. 14-cv-8400, 2016 WL 1169514, at *3 (S.D.N.Y. Mar. 22, 2016) ("The ISDA and CSA expressly outline Deutsche Bank's responsibilities in determining the Net Open Position and the circumstances under which Deutsche Bank can make a margin call. No implied covenant further limiting Deutsche Bank's freedom to determine the margin calculation system can be found on the same subject."); *In re Lehman Bros. Holdings, Inc.*, 541 B.R. 551 (Bankr. S.D.N.Y. 2015) (finding lender had no duty to comply with the covenant of good faith and fair dealing because financial instrument allowed lender to seek additional collateral "at any time with or without reason").
[9] *See Wells Fargo Realty Advisors Funding, Inc. v. Uioli, Inc.*, 872 P.2d 1359 (Colo. Ct. App. 1994).
[10] *See Primavera Familienstifung v. Askin*, 130 F. Supp. 2d 450 (S.D.N.Y. 2001), *amended on reconsideration in part,* 137 F. Supp. 2d 438 (S.D.N.Y. 2001), *and abrogated on other grounds by Casey v. Merck & Co.*, 653 F.3d 95 (2d Cir. 2011).
[11] *See id.* at 532.
[12] *Highland CDO Opportunity Master Fund v. Citibank, N.A.*, No. 12-cv-2827, 2013 WL 1191895 (S.D.N.Y. Mar. 22, 2013).
[13] *In re Am. Home Mortg. Holdings, Inc.*, 388 B.R. 69 (Bankr. D. Del. 2008) (applying New York law).
[14] *See generally* notes 15-25 *infra*.
[15] *See Primavera Familienstifung v. Askin*, 130 F. Supp. 2d 450 (S.D.N.Y. 2001), *amended on reconsideration in part,* 137 F. Supp. 2d 438 (S.D.N.Y. 2001), *and abrogated on other grounds by Casey v. Merck & Co.*, 653 F.3d 95 (2d Cir. 2011).
[16] *Highland CDO Opportunity Master Fund v. Citibank, N.A.*, No. 12-cv-2827, 2013 WL 1191895 (S.D.N.Y. Mar. 22, 2013).
[17] *Id.* at *4.
[18] *Id.*
[19] *CDO Plus Master Fund Ltd. v. Wachovia Bank, N.A.*, No. 07-cv-11078, 2010 WL 3239416 (S.D.N.Y. Aug. 16, 2010).
[20] *Id.* at *4.
[21] *In re Am. Home Mortg. Holdings, Inc.*, 388 B.R. 69 (Bankr. D. Del. 2008) (applying New York law).
[22] *Id.* at 92-93.
[23] *Id.*
[24] *Sher v. Barclays Capital, Inc.*, 35 F. Supp. 3d 725, 734–40 (D. Md. 2014).
[25] *See id.* (noting that investor moved from Merrill Lynch to Icahn and that Icahn made an exception to its 35% margin policy and "fixed his margin requirement at 30%").

[26] *See Primavera Familienstifung v. Askin*, 130 F. Supp. 2d 450, 551–52 (S.D.N.Y. 2001), *amended on reconsideration in part,* 137 F. Supp. 2d 438 (S.D.N.Y. 2001), *and abrogated on other grounds by Casey v. Merck & Co.*, 653 F.3d 95 (2d Cir. 2011) (allowing breach of contract claim to go to the jury where investor contended that broker breached the contract by raising margin requirement above the contractually agreed upon amount without his consent).
[27] *Cf. Sher*, 35 F. Supp. 3d at 741–42 (discussing broker's obligation to act in good faith and commercially reasonable manner).
[28] *Moss v. J.C. Bradford & Co.*, 446 S.E.2d 799, 803–04 (N.C. 1994); *see also Conway v. Icahn & Co.*, 16 F.3d 504, 506 (2d Cir. 1994) (explaining that margin agreement that gave the broker "the right to increase its equity percentage requirement without notice" to the investor).
[29] *VCG Special Opportunities Master Fund Ltd. v. Citibank, N.A.*, 594 F. Supp. 2d 334, 344 (S.D.N.Y. 2008).
[30] *Id.* (citing *Maddaloni Jewelers, Inc. v. Rolex Watch U.S.A., Inc.,* 41 A.D.3d 269, 838 N.Y.S.2d 536 (2007) & *Outback/Empire I, Ltd. P'ship v. Kamitis, Inc.,* 35 A.D.3d 563, 825 N.Y.S.2d 747 (2006)).
[31] *See Patterson v. E*TRADE Clearing, LLC*, No. 16-cv-03388, 2016 WL 6610383, at *1 (N.D. Cal. Nov. 9, 2016) (margin agreement stated that "market conditions permitting, E*TRADE Clearing agrees to make reasonable efforts to notify Customer of any margin call or deficiency and allow Customer a reasonable period of time to cure any margin deficiency.")
[32] *See id.*
[33] *See Veleron Holding, B.V. v. BNP Paribas SA*, 2014 WL 12699263, at *4 (S.D.N.Y. Apr. 16, 2014).
[34] *Id.* at § 9-611(b) & (d); *see also Highland CDO Opportunity Master Fund v. Citibank, N.A.*, No. 12-cv-2827, 2013 WL 1191895, at *10 (S.D.N.Y. Mar. 22, 2013) ("The statutory notice requirements does not apply where the collateral 'threatens to decline speedily in value or is of a type customarily sold on a recognized market.").
[35] Note that the Uniform Commercial Code applies to "security agreements covering personal and real property," U.C.C. § 9-109, which includes loans and most margin trading agreements, but not repurchase agreements. *See, e.g.*, *Am. Home Mortg. Inv. Corp. v. Lehman Bros., Inc. (In re Am. Home Mortg. Holdings, Inc.,* 388 B.R. 69, 92 (Bankr. D. Del. 2008) ("As the MRA is a purchase and sale agreement, the commercial reasonableness standard of Article 9 does not apply....), *Granite Partners, L.P. v. Bear, Stearns & Co., Inc.,* 17 F.Supp.2d 275, 302 (S.D.N.Y. 1998) (the explicit language of the repurchase agreement evidences the parties' intent to treat the transactions as sales and purchases, and not loans, causing the Court to determine, as a matter of law, that the repurchase agreements were not subject to Article 9 of the UCC).
[36] *See, e.g.*, *Highland CDO Opportunity Master Fund*, 2013 WL 1191895, at *8.
[37] *Nat'l Westminster Bank, USA v. Ross*, 130 B.R. 656, 675 (S.D.N.Y. 1991).
[38] *See, e.g.*, *VCG Special Opportunities Master Fund Ltd. v. Citibank, NA*, 594 F. Supp. 2d 334, 342–43 (S.D.N.Y. 2008); *CDO Plus Master Fund Ltd. v. Wachovia Bank, NA.*, No. 07-cv-11078, 2009 WL 2033048, at *6 (S.D.N.Y. July 13, 2009).
[39] *CDO Plus Master Fund Ltd. v. Wachovia Bank, NA.*, No. 07-cv-11078, 2009 WL 2033048, at *6 (S.D.N.Y. July 13, 2009); *see also Highland CDO Opportunity Master Fund, LP v. Citibank, NA*, No. 12-cv-2827, 2013 WL 1191895, at *8 (S.D.N.Y. Mar. 22, 2013).
[40] *Primavera Familienstifung v. Askin*, 130 F. Supp. 2d 450, 534 (S.D.N.Y. 2001), *amended on reconsideration in part,* 137 F. Supp. 2d 438 (S.D.N.Y. 2001), *and abrogated on other grounds by Casey v. Merck & Co.*, 653 F.3d 95 (2d Cir. 2011).
[41] *See Merchants Bank of N.Y. v. Gold Lane Corp.*, 28 A.D.3d 266, 268–269 (N.Y. App. Div. 2006).
[42] While this memo focuses on New York's Uniform Commercial Code, the law of other states is similar. *See, e.g.*, Cal. Commercial Code §§9101-9707; N.J. Stat. Ann. 12A:9-102.
[43] N.Y. U.C.C. Law § 9-610(a).
[44] *Id.* § 9-610(b); *see also Stavinsky v. Prof-2013-S3 Legal Title Trust*, 77 N.Y,S.3d 287, 293 (N.Y. Sup. Ct. 2018).
[45] *Id.* § 9-626(a)(2); *see also id.* § 9-626(a)(1) ("A secured party need not prove compliance with the provisions of this part relating to collection, enforcement, disposition, or acceptance unless the debtor or a secondary obligor places the secured party's compliance at issue.")
[46] *See Atlas MF Mezzanine Borrower, LLC v. Macquerie Tex. Loan Holder, LLC*, No. 651657/2017, Dkt. No. 1137 (N.Y. Sup. Ct. Mar. 26, 2020).
[47] N.Y. U.C.C. Law § 9-627(b).
[48] *See Edgewater Growth Capital Partners LP v. H.I.G. Capital*, 68 A.3d 197, 214 n.84 (Del. Ch. 2013).
[49] *FDIC v. Forte*, 94 A.D.2d 59, 66 (N.Y. App. Div. 1983)(quoting N.Y. U.C.C. Law § 9-507(2)).
[50] N.Y. U.C.C. Law § 9-610 cmt. 10.
[51] 4 White & Summers, Uniform Commercial Code § 34:23 (6th ed.).
[52] *In re Zsa Zsa Ltd.*, 352 F. Supp. 665, 671 (S.D.N.Y. 1972).
[53] *Forte*, 94 A.D.2d at 66.
[54] *See Edgewater Growth Capital Partners LP v. H.I.G. Capital*, 68 A.3d 197, 211 (Del. Ch. 2013).
[55] *In re Excello Press, Inc.*, 890 F.2d 896, 905 (7th Cir. 1989) (applying New York law).

[56] *See Primavera Familienstifung v. Askin*, 130 F. Supp. 2d 450, 546 (S.D.N.Y. 2001), *amended on reconsideration in part,* 137 F. Supp. 2d 438 (S.D.N.Y. 2001), *and abrogated on other grounds by Casey v. Merck & Co.*, 653 F.3d 95 (2d Cir. 2011).
[57] *Atlas MF Mezzanine Borrower, LLC v. Macquearie Tex. Loan Holder, LLC*, 174 A.D.3d 150 (N.Y. App. Div. 2019).
[58] *Seomi v. Sotheby's*, 910 N.Y.S.2d 765, 2010 WL 2293182, at *1–2 & n.3 (N.Y. Sup. Ct. Apr. 27, 2010).
[59] *Coxall v. Clover Commercial Corp.*, 781 N.Y.S.2d 567, 576 (N.Y. Civ. Ct. 2004).
[60] *Vornado PS, LLC v. Primestone Inv. Partners, LP*, 821 A.2d 296, 316 (Del. Ch. 2002), *aff'd* 822 A.2d 397 (Del. 2003).
[61] *Bank Leumi USA v. GM Diamonds, Inc.*, 149 A.D.3d 662, 662–63 (N.Y. App. Div. 2017).
[62] *See* N.Y. U.C.C. Law § 9-620(a)(1). If the contract is not governed by the UCC it may be possible for the parties to contract around this provision to allow the broker to keep the collateral and give the investor credit. *See Sher v. RBC Capital Markets, LLC*, 539 B.R. 260, 265 (D. Md. 2015).
[63] *Edgewater Growth Capital Partners LP v. H.I.G. Capital, Inc.*, 68 A.3d 197, 211 (Del. Ch. 2013).
[64] *See Chittenden Trust Co. v. Andrew Noel Sports*, 621 A.2d 215, 218 (Vt. 1992); *see also Hertz Comm. Leasing Corp. v. Dynatron, Inc.*, 37 Conn. Supp. 7, 13 (1980) ("It would seem that the only items logically included in this category would be widely traded stocks and bonds.")
[65] NY U.C.C. Law § 9-610 cmt. 7.
[66] *Ford Motor Credit Co. v. Soloway*, 825 F.2d 1213, 1218 (7th Cir. 1987) (holding that automobile auction that only automobile dealers were invited to attend did not qualify as a public sale); *John Deery Motors, Inc. v. Steinbronn*, 383 N.W.2d 553, 554–55 (Iowa 1986) (same).
[67] *See, e.g.*, N.Y. U.C.C. Law § 9-615(f) (imposing special obligations in calculating the value of the sale if the purchaser is the secured party or related to the secured party).
[68] *Highland CDO Opportunity Master Fund, LP v. Citibank, NA*, No. 12-cv-2827, 2013 WL 1191895, at *5 (S.D.N.Y. Mar. 22, 2013).
[69] *Id.*
[70] *See Primavera Familienstifung v. Askin*, 130 F. Supp. 2d 450, 546 (S.D.N.Y. 2001), *amended on reconsideration in part,* 137 F. Supp. 2d 438 (S.D.N.Y. 2001), *and abrogated on other grounds by Casey v. Merck & Co.*, 653 F.3d 95 (2d Cir. 2011); *see also In re Solfanelli,* 230 B.R. 54, 67–68 (M.D. Pa. 1999) (creditor acted in commercially unreasonable manner under identical statute to N.Y. U.C.C. § 9–504(3) because inter alia failed to maximize security values where sold majority of securities to itself and then resold at higher price two days later), *aff'd*, 203 F.3d 197 (3d Cir.2000).
[71] *In re Comprehensive Power, Inc.*, 578 B.R. 14, 17 (D. Mass. 2017).
[72] *See Vornado PS LLC v. Primestone Inv. Partners,* 821 A.2d 296, 309–10, 316 (Del. Ch. 2002).
[73] *See Edgewater Growth Capital Partners LP v. H.I.G. Capital, Inc.*, 68 A.3d 197, 202–03 (Del. Apr. 18, 2013).
[74] Sandra S. Stern, *Default: Enforcement and Remedies*, Secured Transactions 2016: What Lawyers Need to Know About UCC Article 9, at § 23.11[2] (2016).
[75] *See Conway v. Icahn & Co.*, 16 F.3d 504, 506 (2d Cir. 1994)
[76] *Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 461 F. Supp. 951, 952 (E.D. Mich. 1978).
[77] *De Kwiatkowski v. Bear, Stearns & Co., Inc.*, 306 F.3d 1293, 1302 (2d Cir. 2002).
[78] *Bissell v. Merrill Lynch & Co.*, 937 F. Supp. 237, 246 (S.D.N.Y. 1996) (quoting *Schenck v. Bear, Stearns & Co.*, 484 F. Supp. 937, 947 (S.D.N.Y. 1979)); *see also In re Smith*, No. 10-22729, 2013 WL 5488708 (D. Conn. Sept. 30, 2013) (same).
[79] *Fesseha v. TD Waterhouse Inv'r Servs., Inc.*, 305 A.D.2d 268, 268–69 (N.Y. App. Div. 2003).
[80] *Conte v. U.S. All. Fed. Credit Union*, 303 F. Supp. 2d 220, 227 (D. Conn. 2004).
[81] *See id.* (citing *Wiener v. Lazard Freres & Co.*, 241 A.D.2d 114 (N.Y. App. Div. 1998)).
[82] *Lehman Bros. Commer. Corp. v. Minmetals Int'l Non-Ferrous Metals Trading Co.*, 179 F. Supp. 2d 118, 151 (S.D.N.Y. 2000).
[83] *Id.* (quoting *Scott v. Dime Sav. Bank*, 886 F. Supp. 1073, 1078 (S.D.N.Y. 1995)).
[84] *Patterson v. E*TRADE Clearing, LLC*, No. 16-cv-03388, 2016 WL 6610383, at *3–5 (N.D. Cal. Nov. 9, 2016).
[85] *Conte v. U.S. All. Fed. Credit Union*, 303 F. Supp. 2d 220, 228 (D. Conn. 2004).
[86] *De Kwiatkowski v. Bear, Stearns & Co., Inc.*, 306 F.3d 1293, 1307 (2d Cir. 2002).
[87] *SNCB Corp. Fin. Ltd. v. Schuster*, 877 F. Supp. 820, 828 (S.D.N.Y. 1994) (quoting *Central Budget Corp. v. Garrett*, 48 A.D.2d 825, 825 (N.Y. App. Div. 1975)).
[88] *See Primavera Familienstifung v. Askin*, 130 F. Supp. 2d 450, 534–36 (S.D.N.Y. 2001), *amended on reconsideration in part,* 137 F. Supp. 2d 438 (S.D.N.Y. 2001), *and abrogated on other grounds by Casey v. Merck & Co.*, 653 F.3d 95 (2d Cir. 2011).
[89] *Id.* at 535; *see also Katara v. D.E. Jones Commodities*, 835 F.2d 966, 972 (2d Cir. 1987) ("Where a customer's position is involuntarily liquidated because of his failure to meet a margin call, application of the general duty to mitigate damages limits recovery to: the additional amount required to repurchase the same contracts in the market within a reasonable time after liquidation . . . measured by the difference between the contracts' liquidation prices and the highest intermediate prices reached by the identical contracts during a reasonable period after the wrongful sale.").
[90] *Primavera Familienstifung*, 130 F. Supp. 2d at 537-38.
[91] *See id.*

[92] *Bank of China v. Chan*, 937 F.2d 780, 787–88 (2d Cir. 1991) ("Normally, when a debtor has defaulted and the creditor has repossessed the collateral then disposed of it unreasonably, the proper way to calculate the effect of the unreasonable acts is to prove the fair market value of the collateral . . . and then subtract the value actually received in order to calculate the loss.").
[93] *Gen. Elec. Credit Corp. v. Durante Bros. & Sons, Inc.*, 79 A.D.2d 509, 510–11 (N.Y. App. Div. 1980) ("[T]here is a presumption that the security was equal to the debt and . . . the secured party has the burden of proof to overcome such presumption." (quoting *Security Trust Co. v. Thomas*, 59 A.D.2d 242, 246 (N.Y. App. Div. 1977))).
[94] *See, e.g.*, *Hammad v. Lewis*, 638 F. Supp. 2d 70, 75 (D.D.C. 2009) (refusing to vacate FINRA decision regarding allegedly improper margin calls); *see also C.L. King & Assoc., Inc. v. N.W. Mut. Life Ins. Co.*, No. 1:18-cv-785, 2019 WL 2869620 at *1 (N.D.N.Y. July 3, 2019) (describing FINRA arbitration regarding margin calls); *cf. Sher v. Goldman Sachs*, No. 11-cv-2796, 2012 WL 1377066, at *6 (D Md. Apr. 19, 2012) (compelling arbitration under margin agreement).
[95] *See Weinrott v. Carp*, 32 N.Y.2d 190, 197 (1973). The exception is if the plaintiff claims the defendant defrauded him with respect to the arbitration clause itself. *See id.*
[96] *See Atl. Marine Constr. Co. v. U.S. District Ct. for the W. Dist. of Tex.*, 134 S.Ct. 568, 583 (2013) ("When parties have contracted in advance to litigate disputes in a particular forum, courts should not unnecessarily disrupt the parties' settled expectations.").
[97] *See Blumenthal v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 910 F.2d 1049, 1052–53 (2d Cir. 1990).
[98] *See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Salvano*, 999 F.2d 211, 215 (7th Cir. 1993).