United States District Court
Northern District of California

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

IN RE ROBINHOOD ORDER FLOW LITIGATION

Case No. 4:20-cv-9328-YGR

ORDER GRANTING IN PART AND DENYING IN PART MOTION TO DISMISS SECOND CONSOLIDATED AMENDED COMPLAINT; GRANTING IN PART AND DENYING IN PART MOTION TO DENY CLASS CERTIFICATION

Dkt. Nos. 99 and 101

Plaintiff Ji Kwon brings this class action complaint against defendants Robinhood Financial LLC ("Robinhood Financial"), Robinhood Securities, LLC ("Robinhood Securities"), and Robinhood Markets, Inc. ("Robinhood Markets") (collectively "Robinhood") on behalf of himself and a class of similarly situated individuals, alleging six false and misleading statements and omissions and fraudulent and manipulative conduct between September 1, 2016 and June 16, 2020 (the "Class Period") (Dkt. No. 93) ("Consolidated Second Amended Class Action Complaint" or "Compl."). Plaintiff asserts three causes of action, each alleging a violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5(a), 10b-5(b), and 10b-5(c) respectively.

Having once considered a motion to dismiss, now before the Court is Robinhood's second motion to dismiss plaintiff's claims pursuant to Federal Rules of Civil Procedure 12(b)(6) and 9(b) and motion to deny class certification (*see* Dkt Nos. 99 and 101). After carefully considering the papers submitted and the pleadings in this action, and for the reasons set forth below, the Court hereby **GRANTS IN PART** both the motion to dismiss, and relatedly, the motion to deny class certification.

I. Background

The below factual background is based on facts from judicially noticeable documents and allegations from plaintiff's complaint.[1]

A. Robinhood's Payment For Order Flow ("PFOF") Business

Robinhood is a "multi-billion dollar mobile application and website investment service." (Compl. ¶ 2.) Users can engage in "self-directed securities brokerage services" by way of Robinhood's website and smartphone applications. (*Id.* ¶ 21.) Robinhood has gained popularity amongst investors by allowing customers to place stock trades "without paying a trading commission fee." (*Id.* ¶ 22.)

Since at least late 2016, PFOF has been Robinhood's largest revenue source. (*Id.* ¶ 7.)

---

[1] Robinhood presents twenty documents in support of its motion to dismiss. For each, Robinhood requests that the Court take judicial notice, or incorporate the document by reference, namely: (1) a copy of Robinhood Financials' SEC Rule 606 disclosure for the first quarter of 2018 (Ex. A); (2) a copy of Robinhood Financials' customer agreement, dated November 21, 2016 (Ex. B); (3) excerpts from trade confirmations (Exs. C and D); (4) media publications concerning Robinhood's receipt of payment for order flow (Exs. E -T). (*See* Dkt. No. 99). Plaintiff challenges each request.

The Court concludes that it may properly take judicial notice of Exhibit A since SEC filings are routinely subject to judicial notice. *See Metzler Inv. GMBH v. Corinthian Colleges, Inc.*, 540 F.3d 1049, 1064 n.7 (9th Cir. 2008) (explaining that it was proper for the district court to take notice of defendant's SEC filings); *see also Dreiling v. Am. Exp. Co.*, 458 F.3d 942, 946 n. 2 (9th Cir. 2006) (SEC filings subject to judicial notice).

Similarly, the Court takes judicial notice of Exhibits E through T, not for the truth of their content, but to "indicate what was in the public realm at the time." *Von Saher v. Norton Simon Museum of Art at Pasadena*, 592 F.3d 954, 960 (9th Cir. 2010); *Gerritsen v. Warner Bros. Entm't Inc.*, 112 F. Supp. 3d 1011, 1028 (C.D. Cal. 2015) ("The cases in which courts take judicial notice of newspaper articles and press releases . . . are limited to a narrow set of circumstances . . . e.g., in *securities cases* for the purpose of showing that particular information was available to the stock market."*); see also, e.g., Heliotrope Gen., Inc. v. Ford Motor Co.*, 189 F.3d 971, 981 n.18 (9th Cir. 1999) (taking judicial notice "that the market was aware of the information contained in news articles submitted by the defendants*"*).

However, because plaintiff disputes the contents of Exhibits B through D and the complaint does not refer to or explicitly rely upon those documents, the request for judicial notice as to these documents is denied. Similarly, the incorporation by reference doctrine does not apply to these documents. Nor does it apply to Exhibit A, but that document is judicially noticeable on the basis described above.

PFOF is the payment or compensation that a brokerage or retail firm receives from principal trading firms directing orders to different market makers. (*Id.* ¶ 26.) Rule 10b-10(d)(8) of the Exchange Act defines PFOF to include "any monetary payment, service, property, or other benefit that results in remuneration, compensation, or consideration to a broker-dealer in return for the routing of customer orders." (*Id.* ¶ 27.) The Securities and Exchange Commission ("SEC") permits the receipt of PFOF so long as it does not interfere with the brokerage or firm's other duties, and as long as such payments are disclosed in the firm's quarterly SEC Rule 606 report. (*Id.* ¶ 29.)

In addition to PFOF, another incentive that principal trading firms may provide to retail broker-dealers is "price improvement" on customers' orders. (*Id.* ¶ 30.) Price improvement allows customers to receive executed orders at prices better than the national best bid and offer ("NBBO"). (*Id.* ¶ 31.)

B. The Duty of Best Execution

Retail brokers such as Robinhood owe their customers a duty of "best execution." (*Id.* ¶ 34.) Best execution requires that a broker endeavor to execute orders at the most favorable terms available at the time of execution. (*Id.*) A broker is not required to examine every single order to determine compliance with its duty of best execution. (*Id.* ¶ 35.) Instead, the duty only requires regular and rigorous reviews of its quality of orders executions. (*Id.*) PFOF has the potential to interfere with a broker firm's way of carrying out its duty of best execution because PFOF is a benefit that goes straight to the broker whereas other incentives that may be obtained for routing PFOF, such as price improvement, benefit the customer. (*Id.* ¶ 36.) In conducting its business, Robinhood agreed to accept less price improvement for its customers than what principal trading firms were offering in exchange for receiving a higher rate of payment for PFOF. (*Id.* ¶ 63.)

In 2016, Robinhood formed a "Best Execution Committee" to monitor its execution speed and price. (*Id.* ¶ 64.) The committee met at least once per month. (*Id.*) In 2017, Robinhood developed a proprietary routing algorithm, known as a smart order router, which routed customer orders to principal trader firms with which Robinhood had payment for order flow arrangements the most price improvement for that stock over the prior 30 days. (*Id.* ¶ 66.) The smart router did not fix Robinhood's PFOF and did not route to firms with whom Robinhood did not have an agreement. (*Id.*) Thus, allegedly the committee did not take any steps to determine whether Robinhood's PFOF was negatively impacting customers' orders, nor did the committee conduct regular reviews to determine whether Robinhood was fulfilling its best execution obligations. (*Id.* ¶¶ 69-70.) Robinhood chose to stop routing orders to one of its principal trading firms mid-2017 when the firm tried to negotiate a lower PFOF rate. (*Id.* ¶ 71.)

In October 2018, Robinhood started comparing its order execution quality to that of its competitors and found that its quality metric was worse than that of its competitors. (*Id.* ¶ 70.) In March 2019, after further testing, Robinhood further learned that its execution quality and price improvement metrics were substantially worse than other retail brokers. (*Id.* ¶ 73.) However, the Best Execution Committee failed to take the necessary steps to ensure that Robinhood was complying with its duty to seek the best execution of trades. (*Id.* ¶ 74.)

C. Pre-Class Period Allegations: Robinhood's Initial FAQ Concerning PFOF

In 2014, prior to its public launch, Robinhood included a Frequently Asked Question ("FAQ") page on its website providing information about the company's anticipated revenue source. (*Id.* ¶ 47.) In response to the question, "How does Robinhood make money?", Robinhood indicated that it anticipated receiving money for PFOF. (*Id.*) During this time, PFOF became publicly scrutinized and was deemed controversial. (*Id.* ¶¶ 49-50.) In light of these concerns, in December 2014, Robinhood revised its FAQ to reflect that "the payment for order flow revenue Robinhood received at the time was 'indirect' and 'negligible'" and that "if payment for order flow ever became a direct or significant source of Revenue, Robinhood would inform customers of those facts on the "How does Robinhood make money" FAQ page." (*Id.* ¶¶ 51-52.) Robinhood's FAQ reflected this language from December 2014 until some time in 2016. (*Id.* ¶¶ 51, 53, 75.) During this time, PFOF constituted more than 80% of the company's revenue. (*Id.* ¶ 53.)

D. Events During the Class Period

(*Id.* ¶ 75.) Between then and September 2018, the FAQ part of Robinhood's website did not include PFOF as a revenue source in its answer to the "How Robinhood Makes Money" FAQ although PFOF was its largest source of revenue throughout this period. (*Id.*) However, the FAQ website was updated throughout this period to include smaller revenue sources. (*Id.* ¶ 78.)

Robinhood featured its "How Robinhood Makes Money" FAQ in some of its customer communications, including its website's homepage. (*Id.* ¶ 80.) Additionally, Robinhood instructed its customer service representations to direct customers to the FAQ page or use the language from its response when customers inquired about how Robinhood made money. (*Id.* ¶ 81.) Training documents for customer representatives "explicitly instructed them to 'avoid' talking about payment for order flow and stated that it was 'incorrect' to identify payment for order flow in response to questions about how Robinhood made money." (*Id.* ¶ 82.)

Robinhood disclosed its receipt of PFOF in its SEC 606 reports, which were published on Robinhood's "Disclosure Library" page of its website. (*Id.* ¶ 84.) Robinhood's customer agreements and trade confirmations also included language indicating that Robinhood "may" receive PFOF even though it was "four times the industry standard." (*Id.* ¶¶ 84, 85.)

On October 12, 2018, Robinhood published a new FAQ page that discussed its receipt of PFOF. (*Id.* ¶ 87.) The new FAQ page also include a statement on Robinhood's execution quality which stated:

> **What is the execution quality for orders on Robinhood?**
>
> Reg NMS ensures your order gets executed at the national best bid and offer, or better, at the time of execution. Our execution quality and speed matches or beat what's found at other major brokerages. Even when measured at the time of routing, our customers' orders get executed at the NBBO or better. By way of example, in August 2018, 99.12% of our customers' marketable orders were executed at the the [sic] national best bid and offer or better with an execution speed of 0.08 seconds from routing to execution (for S&P 500 stocks, during market hours).

(*Id.*)

By contrast, Robinhood's internal analysis conducted after October 2018 showed that Robinhood underperformed other retail brokers with respect to the number of accounts receiving price improvement. (*Id.* ¶¶ 88-92.) In June 2019, Robinhood removed the language from its FAQ

DOCKET ALARM

Explore Litigation Insights

Docket Alarm provides insights to develop a more informed litigation strategy and the peace of mind of knowing you're on top of things.

Real-Time Litigation Alerts

Keep your litigation team up-to-date with **real-time alerts** and advanced team management tools built for the enterprise, all while greatly reducing PACER spend.

Our comprehensive service means we can handle Federal, State, and Administrative courts across the country.

Advanced Docket Research

With over 230 million records, Docket Alarm's cloud-native docket research platform finds what other services can't. Coverage includes Federal, State, plus PTAB, TTAB, ITC and NLRB decisions, all in one place.

Identify arguments that have been successful in the past with full text, pinpoint searching. Link to case law cited within any court document via Fastcase.

Analytics At Your Fingertips

Learn what happened the last time a particular judge, opposing counsel or company faced cases similar to yours.

Advanced out-of-the-box PTAB and TTAB analytics are always at your fingertips.

API

Docket Alarm offers a powerful API (application programming interface) to developers that want to integrate case filings into their apps.

LAW FIRMS

Build custom dashboards for your attorneys and clients with live data direct from the court.

Automate many repetitive legal tasks like conflict checks, document management, and marketing.

FINANCIAL INSTITUTIONS

Litigation and bankruptcy checks for companies and debtors.

E-DISCOVERY AND LEGAL VENDORS

Sync your system to PACER to automate legal marketing.

WHAT WILL YOU BUILD? | sales@docketalarm.com | 1-866-77-FASTCASE

fastcase® Smarter legal research.