SECURITIES ARBITRATION ALERT 2022-32 (8/18/22)

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- ***Medina v. Chase Investment*, FINRA ID No. 21-02874 (New York, NY, Jul. 15, 2022)**

ARTICLES OF INTEREST:

- **Honigsberg, C., Hu, E. & Jackson, R., *Regulatory Arbitrage and the Persistence of Financial Misconduct,* 74:4 STANFORD LAW REVIEW 737 (Apr. 2022)**
- ***J.P. Morgan Fined Another $200K Over Broker's Unsuitable Trades in His Grandma's Accoun*t, ThinkAdvisor (Aug. 9, 2022)**
- ***SEC Awards More Than $16 Million to Two Whistleblowers*, www.sec.gov (Aug. 9, 2022)**
- ***Finra Raises Alarm Bells Over Forged E-Signatures,* Financial Advisor IQ (Aug. 10, 2022)**
- ***Massachusetts High Court Decides Intrastate Delivery Drivers Unable to Ditch Their Arbitration Agreements,* National Law Review (Aug. 10, 2022)**

DID YOU KNOW?

- **National Center for Technology and Dispute Resolution Has an Online ADR Provider List**

ALERT! NO *ALERT* NEXT WEEK. *Our readers know that we usually take a quarterly break in publishing the* Securities Arbitration Alert *at the end of each quarter. That would have translated this year to the June 30* Alert*. As announced in SAA 2022-24 (Jun. 23), however, we decided to delay our customary break until late August. That time is upon us, so we will next week be taking our delayed quarterly break. Look for the next edition of the* SAA *in your e-mailbox the week of August 28. In the meantime, follow us @SecArbAlert and sign up for updates on our weekly blog posts.*

SQUIBS: IN-DEPTH ANALYSIS

MICHIGAN REVISES ATTORNEY CONDUCT RULES TO REGULATE PDAAS IN RETAINER AGREEMENTS. ***Michigan has adopted a new rule of attorney professional conduct requiring informed client consent to predispute arbitration agreements ("PDAA") in retainer agreements.*** The Supreme Court Order issued **June 8** announces promulgation of a new Rule 1.19 of the *Michigan Rules of Professional Conduct*: "A lawyer shall not enter into an agreement for legal services with a client requiring that any dispute between the lawyer and the client be subject to arbitration unless the client provides informed consent in writing to the arbitration provision, which is based on being: (a) reasonably informed in writing regarding the scope and the advantages and disadvantages of the arbitration provision; or (b) independently represented in making the agreement."

Guidance on Informed Consent

The Official Comment offers this guidance on language demonstrating client informed consent to PDAAs (*ed: repeated essentially* verbatim):

(1) By agreeing to arbitration, the client is: (a) waiving the right to a jury trial; (b) potentially waiving the right to take discovery to the same extent as is available in a case litigated in a court; (c) waiving or limiting the right to appeal the result of the arbitration proceeding to specific circumstances established by law; and (d) agreeing to be financially responsible for at least a share of the arbitrator's compensation and the administrative fees associated with the arbitration;

(2) whether the agreement to arbitrate includes arbitration of legal malpractice claims against the lawyer;

(3) identification of the organization or person(s) that will administer the arbitration;

(4) if the client declines to agree to arbitration at the onset of the attorney-client relationship, there is no prohibition against the lawyer and the client agreeing to arbitrate the matter at a later date;

(5) arbitration may be conducted as a private proceeding, unlike litigation in a court;

(6) the parties can select an arbitrator who is experienced in the subject matter of the dispute;

(7) depending on the circumstances, arbitration can be more efficient, expeditious and inexpensive than litigation in a court; and

(8) the client's ability to report unethical conduct by the lawyer is not restricted.

Vigorous Dissent

Justice **Zahra** dissidents, joined by Justice **Vaviano:** "The rule … tips the scale against arbitration by placing procedural hurdles to entering these agreements. I have no doubt that the rule represents a well-intentioned effort to protect clients. But good intentions do not justify needless, ineffective, and potentially deleterious rules. I believe the present rule is all of these." The dissenters also believe the new rule is a strong candidate for Federal Arbitration Act preemption. Five other Justices voted in favor of the Rule, which was published for comments in **December 2021**.

*(ed: *The new rule is effective September 1. **This reminds us of FINRA Rule 2268, which governs the content and placement of PDAAs. ***We're not so sure about FAA preemption; SCOTUS tends to give deference to State oversight of attorney regulation.)*
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FINRA FINES J.P. MORGAN $200K IN *SCHOTTENSTEIN* CASE. ***FINRA has fined J.P. Morgan $200,000 for failure to supervise a broker who was found by arbitrators to have engaged in unauthorized, unsuitable trades on behalf of his grandmother***. In *Schottenstein v. J.P. Morgan Securities LLC*, FINRA ID No. 19-02053 (Boca Raton, FL, Feb. 5, 2021), which we summarized as a Quick Take in SAA 2021-08 (Mar. 4), a family of customers filed an arbitration against J.P. Morgan and two of its brokers. The trades were executed by her grandsons. After 43 hearing sessions, the Panel found the respondents liable for constructive fraud, abuse of fiduciary duty, fraudulent misrepresentations and omissions and (except for one broker) elder abuse, awarding more than $18.6 million in compensatory damages, rescission of an investment, attorney fees in an amount to be decided by a court of competent jurisdiction, and $345,260 in costs and legal fees.

Award Challenged But Later Confirmed
We covered in SAA 2021-10 (Mar. 18) dueling efforts to confirm or vacate the Award. Several bases were asserted in support of the challenge: arbitrator misconduct in refusing to postpone a hearing; award procured by undue mean; evident partiality; arbitrator refusal to hear evidence; and arbitrator misbehavior. Two challenges got our attention: "[I]n response to the Coronavirus Pandemic, the Panel, over Respondents' objections, ordered that the hearings be held by Zoom, rather than in person. No FINRA rule, however, authorizes a panel to make such an order, and doing so contravenes the scope of the parties' agreement to arbitrate. In addition, current Eleventh Circuit law that makes trial subpoenas in virtual arbitration hearings practically unenforceable, which deprived Respondents of key documents and witnesses at the hearing…. Finally, rather than giving these proceedings the attention they deserved, the panel instead texted, slept, and repeatedly wandered off camera. Thus, 'the arbitrators were guilty of . . . misbehavior by which the rights of [Respondents] have been prejudiced[.]' 9 U.S.C. § 10(a)(3)." The Court on **May 9** denied the motion to vacate and confirmed the Award in its entirety. See *Schottenstein v. JP Morgan Securities, LLC*, No. 1:21-cv-20521-BB (S.D. Fla May 9, 2022).)

AWC
An **August 4** letter of acceptance, waiver and consent between FINRA and J.P. Morgan states that: "the firm failed to reasonably supervise [broker's] unsuitable and unauthorized trading in [the customer's] account and failed to reasonably investigate red flags." The firm consents to censure and a $200,000 fine.
(ed: We imagine this is the end of it.)
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SHORT BRIEFS: CONCISE NEWS YOU NEED TO KNOW

SEC PUBLISHES NOTICE ON PROPOSED EXPUNGEMENT RULE CHANGES. COMMENTS DUE SEPTEMBER 6. We reported in SAA 2022-30 (Aug. 4) that FINRA staff had followed up on recent Board approval to file a new expungement rule. Specifically, FINRA on **August 1** filed with the SEC SR-FINRA-2022-024, *Proposed Rule Change to Amend the Codes of Arbitration Procedure to Modify the Current Process relating to the Expungement of Customer Dispute Information.* The introduction to the 298-page rule filing would amend the *Codes*: "to impose requirements on expungement requests (a) filed by an associated person during an investment-related, customer-initiated arbitration ('customer arbitration'), or filed by a party to the customer arbitration on behalf of an associated person ('on-behalf-of request'), or (b) filed by an associated person separate from a customer arbitration ('straight-in request')."
As we said in our editorial comment in # 30: "*Federal Register* publication will trigger the comment period, which we are sure will be robust." We can now report that publication occurred on **August 15** (Vol. 87, No. 156, P. 50170), and that comments are due by **September 6**.
(ed: Comments may be submitted online, referencing SR-FINRA-2022-024.)
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FINRA ISSUES REG NOTICE ON DIGITAL FORGERY. FINRA on **August 3** issued a Regulatory Notice reminding firms of their role in guarding against digital fraud. Regulatory Notice 22-18, *FINRA Reminds Firms of Their Obligation to Supervise for Digital Signature Forgery and Falsification,* notes that: "FINRA has received an increasing number of reports regarding registered representatives and associated persons (representatives) forging or falsifying customer signatures, and in some cases signatures of colleagues or supervisors, through third-party digital signature platforms. Firms have, for example, identified signature issues involving a wide range of forms, including account opening documents and updates, account activity letters, discretionary trading authorizations, wire instructions and internal firm documents related to the review of customer transactions.[] These types of incidents underscore the need for member firms that allow digital signatures to have adequate controls to detect possible instances of signature forgery or falsification." The Notice provides information on: "relevant regulatory obligations; forgery and falsification scenarios firms have reported to FINRA; and methods firms have used to identify those scenarios."
(ed: We'll watch for any increases in arbitration filings involving this issue.)
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SECURITIES EXPERTS ROUNDTABLE ANNOUNCES NEW OFFICERS. The Securities Experts Roundtable ("SER") announced recently that it had elected new officers for **2022-23**: "members voted by proxy or in person at the 2022 Annual Member Meeting & Conference, unanimously elect[ed] the slate of nominees put forth by the Nominating Committee. **Peter Bulger** and **Robert Graham** are continuing on the Board, serving their second consecutive terms as Directors. **Robert Lawson** is returning to the Board for another term after a one-year mandatory break. **Patrick Dennis** and **Charles**

Ranson are serving their first terms as Directors. Members also elected Mr. Graham as the new President-Elect. The Board has appointed Mr. Ranson as the new Treasurer." *(ed: *The non-profit SER, which was founded in 1992, is: "a group of professionals with significant experience as testifying and consulting experts in securities, business and investment-related litigation." **Directors are elected for three year terms and serve on a volunteer basis.)*

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RARE AWARD VACATUR BASED ON FRAUD. The "big four" bases for challenging awards under Federal Arbitration Act ("FAA") section 10 are: arbitrator misconduct, arbitrator bias, arbitrators exceeding their authority under the arbitration agreement; or fraud. Most challenges – successful or not – tend to fall into the first three categories. So, it's rare to see an arbitration award vacated for fraud. *France v. Bernstein*, No. 20-3425 (3rd Cir. Aug. 9, 2022), however, is an exception to the rule. We'll let the Opinion speak for itself: "Under the [FAA] a court may, for example, vacate an award that was procured by fraud, and fraud is exactly what Jason Bernstein says was perpetrated by Todd France in the arbitration underlying this suit. Like something out of the film *Jerry Maguire*, these two sports agents fought over Bernstein's claim that France improperly organized a money-making event for a football player who was then one of Bernstein's clients, all in an effort to induce that player to fire Bernstein and hire France. The matter went to arbitration, and, in pre-hearing discovery, France denied possessing any documents pertaining to the event. He flatly denied having any involvement in the event at all. The end of this tale hasn't been told yet, but this much is now clear: France lied to Bernstein and the arbitrator, though his lies were not uncovered until after the arbitration was decided in his favor. Because the arbitration award was procured by France's fraud, we will reverse the District Court's order confirming the award and will remand with the instruction to vacate it."
(ed: Wow. Rare, indeed.)

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QUICK TAKES: CASES AND AWARDS WORTH READING

***Robert D. Mabe, Inc v. OptumRX*, No. 21-2192 (3rd Cir. Aug. 4, 2022)**: "Over 400 pharmacies joined forces in a lawsuit against OptumRX (Optum), a pharmacy benefits manager, alleging breaches of contract and breaches of duties of good faith and fair dealing, together with violations of certain state statutes. Pointing to arbitration agreements found in various contracts covering almost all of those pharmacies, Optum moved to compel arbitration. The pharmacies opposed the motion, arguing that compelling arbitration would be unconscionable. The District Court agreed with the pharmacies, and Optum timely appealed. We conclude that the District Court erred by applying the wrong standard in ruling on Optum's motion. Per *Guidotti v. Legal Helpers Debt Resolution, LLC*, 716 F.3d 764 (3d Cir. 2013), the District Court—after concluding the pharmacies brought forth sufficient facts to place the arbitration agreements in question— should have allowed discovery limited to the question of arbitrability and then provided Optum an opportunity to renew its motion. It did neither. We will therefore

vacate in part the District Court's order denying Optum's motion to compel arbitration and remand with instructions" (*link to* Guidotti *added by the* Alert.)

***Tecnicas Reunidas De Talara S.A.C. v. SSK Ingenieria Y Construccion S.A.C.*, No. 21-13776 (11th Cir. Jul. 22, 2022)**: "This appeal concerns whether a party to an international arbitration can obtain a vacatur of an adverse arbitral award because two of its attorneys withdrew and joined the opposing party's law firm during the arbitral proceedings. Because Técnicas Reunidas de Talara S.A.C., the losing party in the arbitration, had knowledge of the attorney side-switching but did not object until Técnicas received an adverse award more than a year later, Técnicas waived its right to complain. We affirm the judgment confirming the arbitral award."

***Leenay v. Superior Court of San Bernardino County*, No. E077292 (Calif. Ct. App. 5 (Jul. 22, 2022)**: "Section 1281.4 of the Code of Civil Procedure requires a court to stay an action pending arbitration 'of a controversy which is an issue involved' in the action…. In this writ proceeding, we must decide what the statute means. Specifically, does it authorize the court to stay a plaintiff's action on the basis of a pending arbitration to which the plaintiff is not a party? … We conclude that the trial court erred by granting the motion to stay. Section 1281.4 does not authorize the court to stay a plaintiff's action on the basis of a pending arbitration to which the plaintiff is not a party. Rather, section 1281.4 applies only when a court has ordered parties to arbitration, the arbitrable issue arises in the pending court action, and the parties in the arbitration are also parties to the court action. Under those circumstances, the court must stay the action (or enter a stay with respect to the arbitrable issue, if the issue is severable). (§ 1281.4.) Those circumstances do not exist in this case. We therefore grant Leenay's writ petition" *(links to statute added by the* Alert.).

***Bardavon Health Innovations v. Spurrier Capital*, FINRA ID No. 21-02307 (Kansas City, MO, Jul. 12, 2022)**: A customer alleging that it was charged fees for services not rendered by Respondent broker-dealer loses its case and is held liable to Respondent broker-dealer for $1.6 million in damages on its breach of contract Counterclaim relating to an engagement letter. *Provided courtesy of SAC's ARBchek facility (www.arbchek.com).*

***Medina v. Chase Investment*, FINRA ID No. 21-02874 (New York, NY, Jul. 15, 2022)**: After finding that the request was not subject to tolling, an Arbitrator explains in great detail why he has granted Respondent broker-dealer's Prehearing Motion to Dismiss without prejudice pursuant to FINRA Rule 13206 (Six-year Eligibility Rule) Claimant broker's request for reformation of his Form U5 record. *Provided courtesy of SAC's ARBchek facility (www.arbchek.com).*

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ARTICLES OF INTEREST: RECENT NEWS FROM THE ADR FRONT

Honigsberg, C., Hu, E. & Jackson, R., *Regulatory Arbitrage and the Persistence of Financial Misconduct*, 74:4 STANFORD LAW REVIEW 737 (Apr. 2022): "Financial-

advisor misconduct often has devastating consequences, leading lawmakers to seek tightened investor protections at the federal level. But many advisors can choose whether to be regulated under the federal regime or instead be overseen by state insurance regulators, giving advisors with a history of misconduct reason to select the laxer state-level regulatory environment. Despite extensive debate over the regulation of financial advice, no prior work has examined those incentives.[] Our analysis identifies a limit of federal lawmaking in this area. Federal regulators necessarily rely on state regulators, who may become beholden to the interests of the insurance industry itself rather than the public. We show that more than one in ten state legislators who oversee insurance regulation are now, or were previously, in the business of selling insurance. We argue that existing tools for federal regulation of advisor misconduct risk the unintended consequence of pushing the worst advisors into poorly regulated state regimes."

***SEC Awards More Than $16 Million to Two Whistleblowers*, www.sec.gov (Aug. 9, 2022)** "The Securities and Exchange Commission today announced awards of more than $16 million to two whistleblowers who provided information and assistance in a successful SEC enforcement action.[] The first whistleblower prompted the opening of the investigation and provided information on difficult-to-detect violations. This whistleblower also identified key witnesses and provided critical information, which helped staff in their investigation. As a result, this whistleblower will receive an award of approximately $13 million. The second whistleblower submitted important new information during the course of the investigation and will receive an award of more than $3 million."

***J.P. Morgan Fined Another $200K Over Broker's Unsuitable Trades in His Grandma's Account*, ThinkAdvisor (Aug. 9, 2022)**: "The Financial Industry Regulatory Authority fined J.P. Morgan an additional $200,000 for failing to reasonably supervise a broker who made unsuitable, unauthorized trades in his grandmother's account with the firm.[] From March 2014 through March 2019, Evan Schottenstein, along with his brother, Avi Schottenstein, another rep at the firm, allegedly made the trades in question, which were largely in structured products, according to FINRA." (*ed: See our coverage elsewhere in this* Alert.)

***Finra Raises Alarm Bells Over Forged E-Signatures,* Financial Advisor IQ (Aug. 10, 2022**): "The Financial Industry Regulatory Authority has issued a reminder to its member firms about their responsibility to guard against digital signature forgery and falsification amid an increase in incidents.[] The self-regulator 'has received an increasing number of reports regarding registered representatives and associated persons (representatives) forging or falsifying customer signatures, and in some cases signatures of colleagues or supervisors, through third-party digital signature platforms,' it said in a regulatory notice from last week." (*ed: See our coverage elsewhere in this* Alert.)

***Massachusetts High Court Decides Intrastate Delivery Drivers Unable to Ditch Their Arbitration Agreements*, National Law Review (Aug. 10, 2022)**: "Just days ago, the highest court in Massachusetts -- the Supreme Judicial Court ('SJC') -- decided whether

former food delivery drivers for GrubHub could escape their arbitration agreements and bring a wage and hour class action lawsuit in court. In excellent news for employers operating in the intrastate delivery sector, the SJC held that they could not. *Archer v. GrubHub, Inc.*, SJC-13228. 2022 WL 2964639 (July 27, 2022) ('GrubHub II'). GrubHub II turned on interpretation of § 1 of the Federal Arbitration Act ('FAA'), which exempts seamen, railroad workers, and 'any other class of workers engaged in foreign or interstate commerce' from forced arbitration pursuant to the FAA. *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 112 (2001) ('Circuit City'). Though this latter language could be interpreted broadly, the Supreme Court has held that it is limited to 'transportation workers,' defined as 'those workers actually engaged in the movement of goods in interstate commerce.'"

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DID YOU KNOW?

NATIONAL CENTER FOR TECHNOLOGY AND DISPUTE RESOLUTION HAS AN ONLINE ADR PROVIDER LIST. The National Center for Technology and Dispute Resolution ("NCTDR") maintains an extensive list of online ADR providers. The group's Website says that: "Listing here of an ODR provider is for information purposes only and does not reflect an endorsement by NCTDR."

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Send any messages or inquiries to: George@SecArbAlert.com

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