SECURITIES ARBITRATION ALERT 2022-44 (11/24/22)

George H. Friedman, Editor-in-Chief

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SQUIBS: IN-DEPTH ANALYSIS

EXPUNGEMENT UPDATE: FINRA RESPONDS TO COMMENTS AND FILES AN AMENDMENT; SEC SEEKS COMMENTS ON DISAPPROVAL. ***Those who thought we were nearing the end of the road for FINRA's proposed changes to the expungement process need to rethink their assumptions. There's much going on, including possible SEC disapproval.*** We reported in SAA 2022-41 (Nov. 13) that FINRA had extended to **November 11** the SEC's time to act on the Authority's proposed changes to the expungement process. Much has transpired in the recent past. First, some background, borrowed from our past coverage.

Original Proposal

We reported in SAA 2022-30 (Aug. 4) that FINRA staff had followed up on 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 massive 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')."

***Federal Register* Publication and Comments**

We later reported in SAA 2022-32 (Aug. 18) that *Federal Register* publication occurred on **August 15** (Vol. 87, No. 156, P. 50170), and that comments were due **September 6**. Last, we analyzed in SAA 2022-35 (Sep. 15) the over 40 comment letters that were posted on the SEC's Website. The institutional comment letters – including those from PIABA, NASAA, and SIFMA – were mostly supportive, but suggested further improvements. Individual industry commenters, however, mostly panned the proposed rule changes and the expungement process in general (see our analysis in the **September 14** Blog post, *Institutional Comments, Mostly Supportive But with All Suggesting Further Modifications, on FINRA's Proposed Expungement Changes. Individual Industry Commenters Uniformly Oppose the Rule*).

Extension Given to SEC by FINRA

We had thought it most likely that staff would return to the National Arbitration and Mediation Committee or the Board with changes resulting from the comments received. Then, FINRA would respond to the comments. While at that time there had not yet been a FINRA response to the comments, the Authority on **September 27** extended until **November 11** the SEC's time to act on the rule filing. No explanation was given in Associate General Counsel **Mignon McLemore**'s filing.

FINRA Response to Comments

On **November 10** Ms. McLemore responded to comments in a 35-page, 148 footnote letter. Although FINRA rejected most changes proposed by the commenters, it filed the

same day a [proposed amendment] offering three significant changes. The SEC describes them as follows: "Amendment No. 1 would modify the proposed rule change in three ways. First, it would amend proposed Rules 12805(c)(3)(A) and 13805(c)(3)(A) to state that all customers whose customer arbitrations, civil litigations or customer complaints are a subject of the expungement request are entitled to attend and participate in all aspects of the prehearing conferences and the expungement hearing. Second, it would modify proposed Rules 12805(c)(8)(C) and13805(c)(9)(C) to state that a panel shall not give any evidentiary weight to a decision by a customer or an authorized representative not to attend or participate in an expungement hearing when making a determination of whether expungement is appropriate. Finally, Amendment No.1 would modify the proposed rule change to provide that an associated person shall not file a claim requesting expungement of customer dispute information from the CRD system if the customer dispute information is associated with a customer arbitration or civil litigation in which a panel or court of competent jurisdiction previously found the associated person liable."

Amendment Published and Comments Sought on Disapproval
The Commission on **November 10** noticed the proposed amendment, which was published **November 16** in the *Federal Register* (Vol. 87, No. 220, P. 68779) along with an *Order Instituting Proceedings to Determine Whether to Approve or Disapprove the Proposed Rule Change.* Why the activity on possible disapproval? Says the Order: "The Commission is publishing this order pursuant to Section 19(b)(2)(B) of the Exchange Act to solicit comments on the proposed rule change, as modified by Amendment No.1, and to institute proceedings to determine whether to approve or disapprove the proposed rule change, as modified by Amendment No. 1…. The Commission is instituting proceedings to allow for additional analysis and input concerning whether the proposed rule change, as modified by Amendment No. 1, is consistent with the Exchange Act and the rules thereunder" (footnotes omitted). Comments on the amended rule and potential disproval are due **December 7**. Rebuttals are due by **December 21.**
*(ed: *With apologies to* Alice in Wonderland*, it gets curiouser and curiouser. **As we've said before, this is a complex topic, so better right than rushed.)*
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S.D.N.Y.: ARBITRATORS' DENIAL OF DISCOVERY MOTIONS IS NO REASON TO VACATE AN AWARD. ***A federal court rejected the contention of an unsuccessful customer claimant that a FINRA arbitration panel's failure to compel the respondent broker-dealer to produce evidence amounted to "refusing to hear evidence" and "evident partiality."*** The court decision, *Evan K. Halperin Revocable Living Trust v. Charles Schwab & Co. Inc.*, No. 21-cv-8098 (S.D.N.Y. Sep. 19, 2022) denied the claimant Trust's motion to vacate and granted respondent Schwab's counter-motion to confirm the **August 30, 2021** Award. The identically titled underlying dispute alleged that the Trust was involuntarily logged out of its account with Schwab's online trading platform while attempting to complete various option trades due to "certain security features" of the platform.

The Discovery Process and Award

Since the case turned on the fate of the Trust's eight discovery motions, the Court discusses those motions in some detail. The Panel granted the first motion to compel in part, but denied a subsequent "motion to clarify and/or supplement" that order as: "frivolous and an abuse of the discovery process." In response to the Trust's next set of three discovery motions, which alleged incomplete compliance with the first one, the Panel compelled production of some of the requested documents, but restricted the relevant date range to the calendar year 2018 and ordered the parties to meet and confer on narrowing the scope of disputed dates of trades. The Trust denied the Trust's last three discovery motions, but ordered Schwab to provide an affidavit affirming that electronically stored information (ESI) in the form of fraud parameter reports the Trust demanded it produce did not, in fact, exist, and Schwab complied. After an evidentiary hearing, the Panel issued an Award denying the Trust's claim and ordering it to pay Schwab $100,000 in attorney fees and $42,750.22 in costs.

Some Judicial Housekeeping

Before reaching the merits of the petition to vacate, the Court addresses two steps taken by the Trust in the vacatur proceeding. First, the Trust filed a certificate of default against Schwab on the ground that the latter did not respond to the Trust's first ground for relief. Ruling that "[t]his assertion is demonstrably untrue," the Court vacates the certificate. Secondly, the Court denies the Trust's motion to strike a declaration Schwab filed in court because all of the declaration's exhibits were part of the arbitration record and were therefore entitled to be considered.

Fundamentally Fair…

The Trust raised two bases for vacatur under section 10 of the Federal Arbitration Act ("FAA"). Its first argument was that, in refusing to grant its discovery motions, "the arbitrators were guilty of misconduct in … refusing to hear evidence pertinent and material to the controversy" under subsection (a)(3). The Court construes this ground as requiring a violation of "fundamental fairness" and notes that this provision: "has been 'narrowly construed so as not to impinge on the broad discretion afforded arbitrators to decide what evidence should be presented.'" The Court discerns no violation of fundamental fairness here. On the contrary, it finds: "The Panel's decision to require Schwab to represent in a declaration, under the penalty of perjury, that it does not maintain the specific ESI sought by the Trust speaks to the Panel's careful consideration of the evidentiary issue at hand, rather than any fundamental unfairness." Furthermore, the Trust could have called the affiant of the declaration as a witness to question him on his knowledge of the alleged fraud detection system, but did not.

… And No Evident Partiality

The Trust also argued that the Panel was guilty of "evident partiality" under FAA section 10(a)(2), based on its denials of its discovery motions. The Court likewise rejects this ground because: "Fundamental fairness does not mean that a party must win a minimum percentage of motions." In any case, the Panel agreed in part with some of the Trust's discovery motions, and even required Schwab to submit a sworn declaration affirming

that the fraud parameter reports did not exist. In addition to confirming the Award, the Court awards prejudgment interest on the Award because the Trust did not overcome the presumption in favor of such relief, and provisionally grants attorney fees and costs incurred by Schwab in connection with enforcing the Award, because the arbitration agreement required the party resisting enforcement to pay them.
*(ed: *Seems right to us! ** This Squib was prepared by Harry A. Jacobowitz, President of HAJ Research and Writing LLC. Mr. Jacobowitz, a member of the Pennsylvania bar, and his firm perform legal research and writing for attorneys and handle substantive searches of SAC's Award database. He can be contacted at harryjacobowitz@optimum.net.)*
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SHORT BRIEFS: CONCISE NEWS YOU NEED TO KNOW

FTX SIGNUP AGREEMENT HAS A PDAA. The **November** collapse and bankruptcy filing of the FTX cryptocurrency platform sent shockwaves through the financial world, and where things land for customer relief remains to be determined. While several institutions, including the bankruptcy court, will be involved in sorting out the problem, we note here that the FTX Capital Markets LLC Customer Agreement contains both a class action waiver and predispute arbitration agreement ("PDAA") calling for FINRA's rules. Specifically, paragraph 26(B) provides: "Any controversy or claim arising out of or relating to this Customer Agreement, any other agreement between the Customer and FTX, any Account(s) established hereunder, any transaction therein, shall be settled by arbitration in accordance with the rules of FINRA Dispute Resolution, Inc.…" Whether the SEC, FINRA, the trustee, or other regulators consider themselves bound by the PDAA remains to be seen.
*(ed: *FINRA lists FTX Capital Markets and related entities under "Broker-Dealer Firms We Regulate." The BrokerCheck listing is here. **The FTX entity links were live as of this writing.)*
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FAIR ACT ENACTMENT UNLIKELY, WE THINK. Several bills have been introduced in the 117th Congress to curb mandatory predispute arbitration agreement ("PDAA") use in the consumer and employment areas – including financial services. We know that President Biden on **March 3** signed the *Ending Forced Arbitration of Sexual Assault and Sexual Harassment Act of 2021,* which expressly amended the Federal Arbitration Act ("FAA") to make predispute arbitration agreements voidable at the option of the victim. Among the other arbitration-centric bills still pending is H.R. 963 – the *Forced Arbitration Injustice Repeal (FAIR) Act* – introduced **February 2021** by Rep. **Henry "Hank" Johnson Jr.** of Georgia. If enacted, the *FAIR Act* would ban mandatory arbitration for almost every conceivable transaction that's not a business-to-business or union-management matter. Specifically, this *Act* would amend the FAA to eliminate mandatory PDAAs for disputes involving consumer, investor, employment (including independent contractors), and antitrust matters. Does the proposed law have a chance at enactment before this Congress expires **January 3, 2023**? We think not. Yes, the proposed *FAIR Act* in **March 2022** passed the House by a narrow party-line 222-209

vote, with just one Republican supporting the bill. But the companion Senate bill – S. 505 – has been stuck for months at 39 cosponsors (no Republicans). We just don't see this attempt to amend the FAA to invalidate a broad swath of PDAAs passing the Senate, either in a lame duck session or in the new Senate (which will be split 50-50 or 51-49 Democrat). House prospects next year are poor, given GOP control of that body.
*(ed: *The non-partisan www.govtrack.us Website agrees with us, giving the Act just a 4% chance of becoming law. **Of course, one never knows.)*
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SENATE BANKING COMMITTEE HAD A HEARING ON FINANCIAL SERVICES REGULATION; FINRA WASN'T PART OF IT. The Senate Banking Committee had a **November 15** hearing titled: "Oversight of Financial Regulators: A Strong Banking and Credit Union System for Main Street." The two-hour hearing did not touch on arbitration. The witnesses were: **Michael S. Barr**, Vice Chair for Supervision, Board of Governors of the Federal Reserve System; **Todd M. Harper**, Chair, National Credit Union Administration; **Martin J. Gruenberg**, Acting Chair, Federal Deposit Insurance Corporation; and **Michael J. Hsu**, Acting Comptroller, Office of the Comptroller of the Currency. Chairman **Sherrod Brown** (D-OH) submitted a written statement, as did Ranking Member **Patrick J. Toomey** (R-PA). Neither referenced FINRA or arbitration.
(ed: A video is available here.)
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QUICK TAKES: CASES AND AWARDS WORTH READING

***Global Travel International, Inc. v. Mount Vernon Fire Insurance Company*, No. 22-10227 (11th Cir. Nov. 8, 2022) (per curiam)**: "This is a duty to defend insurance dispute brought by the insured, Global Travel International, Inc. (GTI), seeking a declaration that Mount Vernon Fire Insurance Company (Mt. Vernon) has a duty to defend GTI in a breach of contract arbitration proceeding. GTI appeals from the district court's grant of summary judgment in favor of Mt. Vernon. The order held that Mt Vernon had no duty to defend GTI because the claim fell within a relevant policy exclusion (exclusion Q). An appeal ensued. At issue now is whether the district court erred by holding that the amended arbitration demand's language was akin to 'conclusory buzz words' that do not trigger coverage.[] After careful review of the policy and the allegations in the amended arbitration demand, we affirm the district court's holding for the reasons set out below."

***Lavvan, Inc. v. Amyris, Inc.*, No. 21-1819 (2d Cir. Sept. 15, 2022)**: "The district court correctly decided that there was not 'clear and unmistakable evidence' of an intent to arbitrate arbitrability in the parties' Research, Collaboration and License Agreement ('RCLA'). The RCLA contains two subsections related to dispute resolution, subsection 7.1.1, committing to arbitration '[a]ll disputes that cannot be resolved by the management of both Parties,' and a separate subsection, subsection 7.2.1, specifying that if 'a dispute arises with respect to the scope, ownership, validity, enforceability, revocation or infringement of any Intellectual Property, . . . such dispute will not be submitted to arbitration and either Party may initiate litigation'…. Because the agreement commits some types of disputes to litigation, it does not express a broad intent to arbitrate 'all

aspects of all disputes.'[] Amyris's argument that the RCLA's incorporation of the ICC rules provides 'clear and unmistakable evidence' of an intent to arbitrate arbitrability is unavailing."

***Wisner v. Dignity Health*, No. C094051 (Calif. Ct. App. 3 Nov. 4, 2022)**: "This appeal is from an order striking a complaint under Code of Civil Procedure section 425.16, the anti-SLAPP (strategic lawsuit against public participation) statute. Plaintiff Gary R. Wisner, M.D., who is representing himself, filed a complaint alleging that defendants Dignity Health and the Dignity Health St. Joseph's Medical Center (collectively, SJMC) falsely reported to the National Practitioner Data Bank (NPDB) that Wisner surrendered his clinical privileges while under investigation. The trial court granted a special motion to strike the complaint after concluding that Wisner's claims arose from a protected activity and that Wisner failed to establish a probability of prevailing on the merits. Wisner contests both aspects of the trial court's order, and he also contends the court erred by denying his motion to conduct limited discovery prior to the hearing on the anti-SLAPP motion. Finding no error, we affirm" (footnotes omitted). (*ed: An* Alert *h/t to Editorial Board member Peter R. Boutin, Esq., of Keesal, Young & Logan, for alerting us to this decision.)*

***Flaherty v. LPL Financial*, FINRA ID No. 21-01427 (Los Angeles, CA, Oct. 13, 2022)**: A customer alleging that money transfers occurred in her account, without her authorization, by her daughter prior to and after becoming power of attorney over her mother's brokerage accounts, loses her case. Respondent broker is granted expungement of this matter from his CRD record despite the objection of the customer. *Provided courtesy of SAC's ARBchek facility (www.arbchek.com).*

***Romano v. Centaurus Financial*, FINRA ID No. 21-01782 (San Diego, CA, Oct. 19, 2022)**: A group of customers alleging elder abuse and unsuitability with respect to investments in various real estate investment trusts and mutual funds, including the Apollo Institutional Income Fund, are awarded monetary relief, including punitive damages pursuant to California Civil Code §3294 against a named Respondent broker's estate. *Provided courtesy of SAC's ARBchek facility (www.arbchek.com).*
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ARTICLES OF INTEREST: RECENT NEWS FROM THE ADR FRONT

Barton Legum & Honlet Legum, eds., *The Investment Treaty Arbitration Review* (Jun. 15, 2022): "The Investment Treaty Arbitration Review fulfils an essential function. Updated every year, it provides a current perspective on a quickly evolving topic. Organised by topic rather than by jurisdiction, it allows readers to access rapidly not only the most recent developments on a given subject – from jurisdictional and procedural issues to damages and much more – but also the debate that led to and the context behind those developments."

***Resolving Crypto Disputes Through International Arbitration*, Lexology (Nov. 10, 2022)**:"Commercial disputes are often best settled by arbitration rather than in court. That

applies to disagreements involving cryptoassets as much as to any other area of business, as Andrew Pimlott explains.[] As cryptocurrencies, non-fungible tokens (NFTs), and other cryptoassets continue to grow in popularity – if not always in value – the number of disputes is also increasing. The innovative, fast-moving, lightly regulated, and often 'Wild West nature of the market means there are frequent disagreements between the parties involved. The fact that it is decentralized and international, spanning different countries and legal systems, makes it harder to work out who is in the wrong and how to resolve arguments between crypto issuers, investors, trading platforms, and other participants."

***EEOC's Proposed Strategic Plan Seems Heavy on Litigation, Light on Mediation*, Constangy Brooks Smith & Prophete LLP Employment Blog (Nov. 11, 2022)**: "The U.S. Equal Employment Opportunity Commission has issued a draft Strategic Plan for 2022-26, and is inviting public comments through Monday, December 5.... As our regular readers know, I have been a big fan of the EEOC's mediation program. We haven't always been able to settle, but the overwhelming majority of EEOC mediations I've been involved in did result in settlement. And the EEOC mediators, at least in North Carolina, are great. So it bothers me that the draft Strategic Plan does not have one word about the mediation program. (It's possible that there was one word in there and that I missed it, but I don't think so.) As noted above, my impression is that the agency seems to want to move in the direction of more litigation and more aggressive litigation."

***SEC Charges S&P Global Ratings with Conflict of Interest Violations*, www.sec.gov (Nov. 14, 2022)**: "The Securities and Exchange Commission today charged S&P Global Ratings, a nationally recognized statistical rating organization (NRSRO) registered with the Commission, with violating conflict of interest rules designed to prevent sales and marketing considerations from influencing credit ratings.[] The SEC's order finds that an issuer engaged S&P to rate a jumbo residential mortgage backed security transaction in July 2017. Over a five-day period in August 2017, S&P commercial employees—employees responsible for managing the relationship with the issuer—on several occasions attempted to pressure the S&P analytical employees—employees responsible for evaluating and assigning the rating—to rate the transaction consistent with preliminary feedback the analytical employees had given the customer that turned out to include a calculation error."

***Finra Announces Probe of Crypto-Related Communications Practices*, Financial Advisor IQ (Nov. 15, 2022)**: "The Financial Industry Regulatory Authority says it has started a targeted examination of practices related to communications about cryptocurrency assets and services.[] The industry's watchdog is asking firms to provide communications related to assets issued or transferred via distributed ledger or blockchain technology — including virtual currencies, coins and tokens, among others — sent between July 1 and September 30 this year, in cases in which the communications went to more than 25 retail investors within any 30 calendar-day period."

***FTX Collapse Comes Amid a Surge in Crypto Related Scams*, TheStreet (Nov. 16, 2022)**: "It's called 'pig butchering' but it has nothing to do with a slaughterhouse.[] The term refers to a certain scam that fraudsters use to cheat cryptocurrency investors, according to a November 10 complaint bulletin from the Consumer Financial Protection Bureau that analyzes a rise in crypto-asset complaints.[] 'Our analysis of consumer complaints suggests that bad actors are leveraging crypto-assets to perpetrate fraud on the public,' CFPB Director Rohit Chopra said in a statement. 'Americans are also reporting transaction problems, frozen accounts, and lost savings when it comes to crypto-assets.'[] Chopra said people should be wary of anyone seeking upfront payment in crypto-assets, since this may be a scam."
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DID YOU KNOW?

AN IMPRESIVE LIST OF ONLINE ADR PROVIDERS. The COVID pandemic accelerated a move toward online ADR. But did you know there's a list of online ADR institutions worldwide available at https://odr.info/provider-list/? This Website, which is maintained by the National Center for Technology & Dispute Resolution, has links to each entity. FINRA and AAA are on the list.
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