SECURITIES ARBITRATION ALERT 2023-03 (1/19/23)

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SQUIBS: IN-DEPTH ANALYSIS

FINRA RELEASES 2023 RISK MONITORING AND RISK PRIORITIES. AGAIN A HEAVY FOCUS ON *REG BI* IMPLEMENTATION. *FINRA announced its 2023 risk monitoring and exam priorities, with a continued emphasis on* Regulation Best Interest *compliance and new focus areas.* We reported in SAA 2023-01 (Jan. 5) that FINRA's Board had met in mid-**December** and among other activities had previewed the

2023 Report on FINRA's Examination and Risk Monitoring Program: "which will provide firms with insight into findings from recent oversight activities of FINRA's Regulatory Operations to help inform the development and operation of firms' compliance programs." The post-meeting memo added that FINRA planned to release the report early in the new year, which is much earlier than in recent years. True to its word, the Authority on **January 10** by press release published the goals.

Reg BI Compliance is Back

As we have reported several times, the SEC issued its final *Regulation Best Interest* ("*Reg BI")* Rule package in **June 2019**. Two items were effective immediately on publication: *Commission Interpretation Regarding Standard of Conduct for Investment Advisers* (84 FR 33669) and *Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser* (84 FR 33681). Two other items went into effect **September 2019**, specifically *Reg BI* (84 FR 33318) and Final Rule - *Form CRS Relationship Summary and Form ADV Amendments* (84 FR 33492). Although *Reg BI* was effective in September 2019, compliance was not required until **June 30, 2020**.

New Focus Areas

The 75-page report, *2023 Report on FINRA's Examination and Risk Monitoring Program*, addresses: "a materially broader range of topics than in prior years (particularly in the Market Integrity section). Additionally, the Report introduces a new Financial Crimes section, consisting of three topics—Anti-Money Laundering (AML), Fraud and Sanctions; Cybersecurity and Technological Governance; and Manipulative Trading—that highlight FINRA's increased focus on protecting investors and safeguarding market integrity against these ongoing threats." The release identifies several core focus areas (*ed: repeated essentially* verbatim); each section has conclusions and recommendations:

New Topics Covered in the Report:

- **Manipulative Trading**. The report's findings include inadequate written supervisory procedures, non-specific surveillance thresholds and surveillance deficiencies.
- **Fixed Income – Fair Pricing**. Among the findings are incorrect determination of prevailing market price, outdated mark-up/mark-down grids, failure to consider the impact of mark-up on yield to maturity and unreasonable supervision.
- **Fractional Shares**. Reporting failures and inadequate supervisory systems and procedures are among the findings.
- **Regulation SHO**. This section includes findings on non-bona fide market making and impermissible reuse of locates.
- **Financial Crimes**. Consisting of three topics — Cybersecurity and Technological Governance; Anti-Money Laundering, Fraud and Sanctions; and Manipulative Trading — this section highlights FINRA's increased focus on protecting investors and safeguarding market integrity against these ongoing threats.

Other Key Topics Include:

- **Cybersecurity.** Cybersecurity threats continue to be one of the most significant risks facing many customers and firms. The frequency, sophistication and variety of attacks continue to increase.
- **Complex Products**. As discussed in the report, FINRA will continue to review firms' communications and disclosures to customers relating to complex products. FINRA will also review customer account activity to assess whether firms' recommendations regarding these products are in the best interest of retail customers given their investment profiles and the potential risks, rewards and costs associated with the recommendations.
- **Regulation Best Interest (Reg BI) and Form CRS**. To provide firms with more information regarding these regulations, the report sets forth updated observations of FINRA's review of firms' compliance with Reg BI and Form CRS. These include observations relating to firms' identifying and addressing conflicts of interest; disclosing to retail customers all material facts related to conflicts of interest; establishing and enforcing adequate written supervisory procedures; and filing, delivering and tracking an accurate Form CRS.
- **Mobile Apps**. The report discusses FINRA's observations of potential issues with some mobile apps, including apps that do not adequately distinguish between products and services of the broker-dealer and those of affiliates or third parties (such as transactions involving crypto assets). It also touches on mobile apps' disclosures and explanations of higher-risk products or services, such as certain options and margin lending activities.

Arbitration Again Doesn't Make the Cut
In 2017, Dispute Resolution was included in FINRA's regulatory priorities for the first time in years. That was not the case this year nor the five prior years, although there are passing references to past arbitrations in "Regulatory Obligations" and "Counterparty Exposure." That's not necessarily a bad sign; if there were perceived problems with the program, we're sure it would be a focus area.
(ed: Kudos again to FINRA for letting firms (and investors) know about what areas the Authority intends to focus.)
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CA'S ARBITRATION STATUTE ON UNPAID ARBITRATION FEES DOES NOT REQUIRE A FINDING FROM THE ARBITRATOR AND APPLIES TO VOLUNTARY ARBITRATION AGREEMENTS. ***The California statute allowing a consumer to evade an arbitration agreement if a business does not pay its share of arbitration fees does not require an affirmative finding from an arbitrator and applies to voluntary arbitration agreements.*** Not long ago, we covered in SAA 2022-46 (Dec. 8) *De Leon v. Juanita's Foods*, No. B315394 (Calif. Ct. App. 2 Nov. 23, 2022. Quoting the *De Leon* Court: "California Code of Civil Procedure sections 1281.97 and 1281.98: "provide that if a company or business that drafts an arbitration agreement does not pay its share of required arbitration fees or costs within 30 days after they are due, the

company or business is in 'material breach' of the arbitration agreement. (Code Civ. Proc., §§ 1281.97, subd. (a)(1); 1281.98, subd. (a)(1). In the case of such a material breach, an employee or consumer can, among other things, withdraw his or her claim from arbitration and proceed in court. (§§ 1281.97, subd. (b)(1); 1281.98, subd. (b)(1).)" Next, the facts: "Following commencement of arbitration proceedings between appellant Juanita's Foods and respondent Kail De Leon, Juanita's Foods failed to pay its share of arbitration fees within 30 days after such fees were due. Based on that late payment, the trial court concluded that Juanita's Foods was in material breach of the parties' arbitration agreement and allowed De Leon to proceed with his claims against Juanita's Foods in court." The arguments? "Juanita's Foods argues that the trial court should have considered factors in addition to its late payment—for example, whether the late payment delayed arbitration proceedings or prejudiced De Leon—to determine the existence of a material breach of the arbitration agreement." And, the holding: "We conclude that the trial court correctly declined to consider these additional factors, and we affirm."

No Need for Finding from an Arbitrator …

The issues before the Court in *Williams v. West Coast Hospitals, Inc*., No. H049177 (Calif. Ct. App. 6 Dec. 22, 2022), were: "to decide (1) whether sections 1281.97 or 1281.98 required plaintiffs … to first obtain an arbitrator's determination of West Coast's default before returning to the trial court; and (2) whether these statutory provisions apply only to mandatory predispute arbitration agreements." Based on statutory construction and legislative history, the Court holds in the negative on both questions. On the need for an arbitrator to make a finding, the Opinion says: "Because nothing in the statute authorizes the restrictive interpretation that West Coast posits, we affirm the trial court's order permitting the resumption of litigation.... [W]e see no hint from the Legislature of any requirement for consumers to first seek a purely ministerial determination from the arbitrator before making the election the Legislature has empowered them to make unilaterally. Although the clarity of the statute's text obviates the need for further inquiry, we observe that the legislative history is consistent with the statute's plain language."

… and No Distinction Between Mandatory and Voluntary Arbitration

On the voluntary vs. mandatory arbitration issue, the Court states: "The Legislature similarly chose not to condition the remedies of sections 1281.97 and 1281.98 on litigation of the voluntary or mandatory character of the predispute execution of the arbitration agreement. To limit the scope of the statute to mandatory arbitration agreements would, furthermore, invite ancillary litigation of voluntariness that would undermine the purpose of the statute.... We will not disturb the balance struck by the Legislature. Accordingly, we conclude that whether an arbitration agreement was 'mandatory' or 'voluntary' in its execution is immaterial to the section 1281.98 analysis." *(ed: Seems right. In our experience, the administrator will deem the case withdrawn well before an arbitrator is appointed.)*

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MORE ON FINRA'S FILING OF RULE CHANGE PROPOSAL IMPLEMENTING "RIGGED PANELS" INVESTIGATION REPORT RECOMMENDATIONS. We reported in SAA 2023-01 (Jan. 5) that, on the eve of the year-end holiday break, FINRA had filed a rule change proposal that would implement recommendations resulting from the outside investigation of allegations that the arbitrator selection process was rigged. As summarized in SAA 2022-38 (Oct. 13), FINRA in **June 2022** released a 37-page *Report of the Independent Review of FINRA's Dispute Resolution Services – Arbitrator Selection Process*, which was announced in a corporate Press Release and a separate statement from the Audit Committee. The investigation was directed by **Christopher Gerold**, a partner in Lowenstein Sandler LLP's Securities Litigation and Corporate Investigations & Integrity Practice Groups. FINRA's management accepted all recommendations, and now posts on its Website a live progress report on implementation. *Status Report on Lowenstein Sandler LLP Recommendations* shows that most items have been implemented or were "in progress." The latest step was accomplished on **December 23, 2022**, when FINRA filed with the SEC SR-FINRA-2022-033, *Proposed Rule Change to Amend the Codes of Arbitration Procedure.* The filing describes it as: "a proposed rule change to amend the Code of Arbitration Procedure for Customer Disputes ('Customer Code') and the Code of Arbitration Procedure for Industry Disputes ('Industry Code') (together, 'Codes') to make changes to provisions relating to the arbitrator list selection process in response to recommendations in the report of independent counsel Lowenstein Sandler LLP. The proposed rule change also makes clarifying and technical changes to requirements in the Codes for holding prehearing conferences and hearing sessions, initiating and responding to claims, motion practice, claim and case dismissals, and providing a hearing record." We promised to provide more detail in a future *Alert*, but instead refer readers to published analyses of the 96-page rule filing: *Finra Proposes Tweaks to Arbitrator Selection*, AdvisorHub (Jan. 3, 2023); *Finra Moves to Make Arbitrator Selection Process More Transparent*, Financial Advisor (Jan. 5, 2023); and *Finra Floats Revamped Arbitrator-Selection Process*, Financial Advisor IQ (Jan. 6, 2023).
*(ed: *The proposed rule was published in the* Federal Register *on January 12 (Vol. 88, No. 8, P. 2144), making comments due February 2. Use this link to submit a comment.*
***The rule filing's progress can be tracked here.)*
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NY AG TO AAA: DON'T ADMINISTER CASES ARISING FROM UNFAIR EMPLOYMENT AGREEMENTS. New York Attorney General **Letitia James** has written to the American Arbitration Association ("AAA"), urging that it refuse to administer certain employment cases. A **January 4** Bloomberg story says that the State is concerned about arbitrators enforcing clauses: "from companies seeking hefty financial penalties from workers who quit their jobs …." Specifically, the letter states: "We request that the AAA consider the serious implications of proceeding with these arbitrations and not allow its arbitration program to be used as a tool by employers to further labor trafficking violations." The letter also cited a pending arbitration New York wanted stayed. The article adds: "According to the state, hospitals and staffing agencies have

long sought to fill jobs by recruiting nurses from other countries, and requiring them to sign employment contracts with unlawful fees of as much as $25,000 if they quit or are fired within three years."
*(ed: *AAA has a longstanding policy of requiring a court order staying a pending case. We suspect that will be the AAA's position. **This one presents thorny issues. For example, if a party or the AAA submits the A.G.'s letter to the arbitrators in a pending case,* Code of Ethics *Canon I(D) may come into play. It provides: "Arbitrators should conduct themselves in a way that is fair to all parties and should not be swayed by outside pressure, public clamor, and fear of criticism or self-interest. They should avoid conduct and statements that give the appearance of partiality toward or against any party." ***Recall that National Arbitration Forum signed a consent decree with Minnesota in 2009 agreeing not to administer consumer arbitrations.)*
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PARTIES CANNOT EXTEND FAA'S TIME FOR MOVING TO VACATE, SIXTH CIRCUIT HOLDS. Just as SCOTUS held in *Hall Street Associates v. Mattel*, 552 U.S. 576 (2008), that the parties cannot agree to expand the scope of judicial review under the Federal Arbitration Act ("FAA"), the Sixth Circuit finds in *Bachman Sunny Hill Fruit Farms v. Producers Agriculture Insurance Co.*, No. 21-2868 (6th Cir. Jan. 11, 2023), that the parties have no authority to expand the three-month period for moving to vacate set forth in FAA section 12. Says the Court: "In short, Bachman Farms has offered no authority to support the proposition that parties to the common policy can extend the three-month deadline in §12 of the FAA for seeking vacatur. Without the ability to extend that deadline, its petition must be barred by the three month time limit in § 12 of the FAA." (footnotes omitted)."
(ed: Seems right.)
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QUICK TAKES: CASES AND AWARDS WORTH READING

***Houtchens v. Google LLC*, No. 22-cv-02638-BLF (N.D. Calif. Dec. 16, 2022)**: "The Court finds that the hyperlinks to Fitbit's Terms of Service in each of the above screens provided Plaintiffs 'reasonably conspicuous notice' of the terms. In the first three screens, the hyperlinks to Fitbit's Terms of Service are presented in blue text in a sentence that otherwise uses gray text; they are next to the box a user must select to accept the terms; and the screens on which they appear are uncluttered. Courts have routinely found that such a presentation supplies reasonably conspicuous notice of hyperlinked terms. In the final screen, the hyperlinks are again presented next to the box that a user must select to accept the terms and the screen on which they appear is uncluttered; but instead of using blue font to distinguish the hyperlinks from the surrounding text, the page uses bold-underlined font. The Court finds that this page, too, provides reasonably conspicuous notice of the terms to which a consumer will be bound" (citations omitted).

***Reichert v. Rapid Investments, Inc*., No. 21-35530 (9th Cir. Dec. 30, 2022) (per curiam)**: "Plaintiff Gary Moyer was incarcerated in the Kitsap County Jail three times. In each instance, the jail confiscated his cash at booking and returned it to him upon release

not in cash or by check, but in the form of a prepaid debit or 'release' card issued and serviced, respectively, by defendants Cache Valley Bank and Rapid Investments, Inc. (collectively, 'Rapid'). The cards, which Moyer did not request and to which no alternative was offered, were delivered to Moyer pre-activated, and in two of the three instances began to charge maintenance fees before Moyer conducted a single transaction…. We hold that Moyer did not agree to the cardholder agreement or its mandatory arbitration clause. Because acceptance is an issue of contract formation, it requires judicial resolution. Accordingly, we affirm the district court's order denying Rapid's motion to compel arbitration."

***Dentons US LLP v. Zhang*, No. 653795/21 (NY App. Div., 1st Dept. Dec. 29, 2022)**: "Contrary to respondent's contention, the law firm partnership agreement between the parties contains a clear and unmistakable delegation clause that delegated questions of arbitrability to the arbitrator (see *Zhang v Superior Ct. of Los Angeles County*, 2022 WL 16832570, *6, 2022 Cal App LEXIS 926, *15-16 [Cal Ct App 2022]). The agreement's arbitration provision, which stipulated Chicago or New York as the place for arbitration, applies to 'all disputes of any kind' and incorporates the rules of the CPR, including the rules that give CPR arbitrators the power to rule on their own jurisdiction to decide what, if any, issues are not to be decided by the arbitrator." See our past coverage in SAA 2022-43 (Nov. 17) of *Zhang v. Super. Ct.*, No. B314386 (Calif. Ct. App. 2 Nov. 9, 2022): "Petitioner sought a writ of mandate, which we denied. The Supreme Court granted review and transferred the case back to us, directing us to issue an order to show cause. We did so, and now again deny the petition. We agree with the trial court that the parties delegated questions of arbitrability to the arbitrator. The arbitrability issues in this case include whether petitioner is an employee who may invoke Labor Code section 925 and require the merits of the dispute to be resolved in California instead of New York. We reject petitioner's contention that, because he invoked section 925, the New York court is not 'a court of competent jurisdiction' (Code Civ. Proc., § 1281.4) that can order arbitration of this dispute." We covered the referenced California Supreme Court decision in SAA 2022-09 (Mar. 10), where we wrote: ***Zhang v. Superior Court (Dentons U.S.)*, No. S272152 (Calif. Feb. 16, 2022)**: "The petition for review is granted. The matter is transferred to the Court of Appeal, Second Appellate District, Division Eight, with directions to vacate its order denying mandate and to issue an order directing respondent court to show cause why the relief sought in the petition should not be granted. (Cal. Rules of Court, rule 8.528(d).) The request for a stay of the trial court's order lifting its injunction against the New York arbitration is granted, subject to further consideration by the Court of Appeal." (*ed: An* Alert *h/t to Editorial Board member Peter R. Boutin, Esq., of Keesal, Young & Logan, for alerting us to these decisions.)*

***Valiente v. LPL Financial*, FINRA ID No. 22-00522 (Los Angeles, CA, Nov. 28, 2022)**: An Arbitrator grants Respondent broker-dealer's Motion for Directed Verdict pursuant to FINRA Rule 13206 of the Code (Six-year Eligibility Rule for Industry Disputes), after finding that 11 years had elapsed since the events giving rise to the claim. *Provided courtesy of SAC's ARBchek facility (www.arbchek.com).*

***Miller v. TD Private Client*, FINRA ID No. 21-02507 (Hartford, CT, Dec. 5, 2022)**: An All-Public Panel explains in detail why it has decided to award Claimant broker damages pursuant to the Bankruptcy Code 11 USC §525(b). The Panel also grants the broker's request for reformation of defamatory information in his Form U5 record but denied all of his statutory employment discrimination claims. *Provided courtesy of SAC's ARBchek facility (www.arbchek.com).*
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ARTICLES OF INTEREST: RECENT NEWS FROM THE ADR FRONT

Corbett, William R., *The Case in Favor of Waivable Employee Rights: A Contrarian View*, Louisiana State University Law Center (Jan. 10, 2023): "Most employee rights in U.S. labor and employment law are nonwaivable. Waivable employee rights exist most prominently in the law regarding noncompetes and mandatory arbitration agreements. In recent years, there has been substantial backlash against perceived employer confiscation of workers' rights in these two areas. On January 5, 2023, the Federal Trade Commission issued a proposed rule prohibiting employers from entering into noncompete agreements with workers. In 2022, President Biden signed the Ending Forced Arbitration of Sexual Assault and Sexual Harassment Act of 2021. Clearly, the federal government has become concerned with employers' opportunistic confiscation of employees' waivable rights and acted to make them nonwaivable in some contexts. This movement is consistent with the fact that almost all federal statutory rights of employees are nonwaivable. Against this backdrop, this article makes a contrarian argument for expansion of waivable statutory employee rights."

***CFPB Attempts to Expand Scope of Nonbank Surveillance*, Husch Blackwell Blog (Jan. 9, 2023)**: "Without its typical fanfare, the CFPB has revealed a plan to propose a rule titled 'Nonbank Registration – Terms and Conditions' in its 'Agency Rule List - Fall 2022.' The description of the proposed rule is scant, a mere two-and-a-half lines. The description indicates an intent by the CFPB to require supervised nonbank entities to register with the agency and to collect 'standard terms used [by non-bank entities] in contracts that are not subject to negotiating or that are not prominently advertised in marketing.' It is unclear exactly what the CFPB would target, including whether just certain terms would have to be registered or if the CFPB would require registration of any form that contains certain terms. According to a recent article appearing in *Law360,* one of CFPB's focus areas will be on arbitration agreements."

***SEC Announces Appointment of Cristina Martin Firvida as Investor Advocate*, www.sec.gov (Jan. 10, 2023)**: "The Securities and Exchange Commission today announced the appointment of Cristina Martin Firvida as Director of the Office of the Investor Advocate, effective Jan. 17, 2023. Ms. Martin Firvida was most recently the Vice President of Financial Security and Livable Communities for Government Affairs at AARP.[] As the Investor Advocate, Ms. Martin Firvida will lead an office that assists retail investors in interactions with the Commission and with self-regulatory organizations (SROs), analyzing the impact on investors of proposed rules and regulations, identifying problems that investors have with financial service providers and

investment products, and proposing legislative or regulatory changes to promote the interests of investors."

FINRA Flags Rising Risk of Scams Targeting Seniors, **Investment Executive (Jan. 11, 2023)**: "The victimization of senior investors and manipulative trading in small-cap initial public offerings (IPOs) are among the emerging risks flagged by the U.S. Financial Industry Regulatory Authority Inc. (FINRA) in a new report on its recent industry compliance reviews.[] The U.S. industry self-regulatory organization published a report that details the latest findings of its compliance examination and risk monitoring programs.[] Among other things, the report flagged new concerns for regulators, such as inadequate supervision to guard against manipulative trading, fair pricing practices in fixed-income markets, compliance with short-selling rules, and oversight of firms dealing in fractional shares.[] It also pointed to an emerging financial crime risk involving the exploitation of senior investors." (*ed: See our coverage elsewhere in this* Alert.)

Plaintiff Lawyers Welcome Finra's Proposal But Want More Arbitration Transparency**, AdvisorHub (Jan. 11, 2023)**: "The Financial Industry Regulatory Authority's proposal to tweak its arbitrator-selection procedures, making them more transparent, represents welcome progress, according to lawyers engaged in related practices. But, at the same time, the lawyers express the need for Finra to make additional modifications.[] 'FINRA gets credit where credit's due; they have made meaningful strides in promoting transparency,' said Hugh Berkson, the president of the Public Investors Advocate Bar Association."

Volunteer Registrations for the 18th Mediation Competition is Now OPEN**, ICC (Jan. 12, 2023)**: "Volunteer at the 18th International Chamber of Commerce (ICC) International Commercial Mediation Competition![] The ICC's largest annual educational event is taking place in Paris from 6-11 February 2023 and we need you! [] Be part of a team of 40+ volunteers and support 120+ professional mediators and judges to conduct 70+ mock sessions with 48 student teams from 30 countries.[] Volunteering as a Mediation Session Supervisor (MSS) for the 18th International Commercial Mediation Competition means deepening your understanding of mediation and broadening your network."

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DID YOU KNOW?

INTERNATIONAL ARBITRATION STATS ARE AVAILABLE ONLINE. An article, *Arbitration Statistics 2021 – Have the Numbers of Arbitration Proceedings Reached their Ceiling?,* published **November 23** in Baker & McKenzie's *Global Arbitration News,* provides detailed statistics on international arbitration case filings for **2012-21**. The link-rich article states that 7,389 international arbitrations were filed in 2021 (*ed: 2022 is not yet available*). The big three in 2021 arbitration filings were: China International Economic and Trade Arbitration Commission (4,071 cases); AAA's International Center for Dispute Resolution (882 cases*); and the International Chamber of Commerce (853 cases). However, CIETAC's figure includes domestic cases; there

were only 830 purely international cases. While investment-related disputes presumably were filed at all twelve institutions cited by Baker & McKenzie, one – the International Centre for Settlement of Investment Disputes – is dedicated to these disputes. ICSID reported 66 cases. The article also has info on case processing.
*(ed: *AAA data is from 2019. Newer stats are marked "n/a". **Wonder how many international arbitrations were filed at FINRA last year?)*
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CLARIFICATION

FINRA'S PANEL DEMOGRAPHIC STATS EXPLAINED: A couple of eagle-eyed readers – Editorial Advisory Board members **William Nelson** and **Rick Ryder** – have pointed out that the **2017** FINRA roster age stats in our coverage in SAA 2023-02 (Jan. 12) and our **January 11** blog post, *FINRA DRS Updates Panel Diversity Data: Impressive Progress Continues*, don't add up to 100%:

- 70 and over 39%
- 61-69 ..... 27%
- 60 and under 29%

Total: 95%

Since this category covers all ages, the total should be 100% (as is the case for the other years). We asked FINRA for an explanation, and the response was that, in the earlier years, arbitrators did not have to answer a question in order to proceed to the next question. As a result, some of the categories do not always add up to 100%. Later, FINRA started adding the option "Prefer Not to Answer," thus forcing a response so the category totaled 100%. The *Alert* thanks FINRA for the prompt response.
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