SECURITIES ARBITRATION ALERT 2023-22 (6/8/23)

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DID YOU KNOW?

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SQUIBS: IN-DEPTH ANALYSIS

JUNE MARKS ONE YEAR ANNIVERSARY OF "RIGGED PANELS" INVESTIGATION REPORT. ***It's been a year since the publication of recommendations resulting from the outside investigation of allegations that the FINRA arbitrator selection process was rigged. We thought we would check in on their progress***. First, some background.

Brief History: Award Vacated by Trial Court

To review succinctly, Fulton County Superior Court Judge **Belinda E. Edwards** in *Leggett v. Wells Fargo Clearing Services, LLC*, No. 2019CV328949 (Ga. Super Jan. 25,

2022), vacated the Award in what might be considered a primer on the basic Federal Arbitration Act grounds for vacating an award (i.e., fraud, arbitrator bias, arbitrator misconduct in not hearing relevant or material evidence or failing to grant a reasonable postponement request; or the panel exceeding authority). Although the Trial Court found all of these bases for vacating the Award, Judge Edwards weighed in on interference with the Neutral List Selection System with some scathing verbiage:

> The Court's factual review of the record evidence leads to its finding that Wells Fargo and its counsel manipulated the FINRA arbitrator selection process in violation of the FINRA Code of Arbitration Procedure, denying the Investors' their contractual right to a neutral, computer-generated list of potential arbitrators. Wells Fargo and its counsel, Terry Weiss, admit that FINRA provides any client Terry Weiss represents with a subset of arbitrators in which certain arbitrators (at least three, but perhaps more) are removed from the list Wells Fargo agreed, by contract, to provide to the Investors in the event of a dispute. Permitting one lawyer to secretly red line the neutral list makes the list anything but neutral, and calls into question the entire fairness of the arbitral forum.

Award "Unvacated"

Wells appealed, and, in a unanimous decision, the Georgia Court of Appeals reinstated the Award in *Wells Fargo Clearing Services, LLC v. Leggett*, No. A22A1149 (Ga. Ct. App. Aug. 2, 2022). The unanimous decision rejects all bases upon which Judge Edwards vacated the Award. As to "secret deals" between FINRA and Wells' then-attorney, the Court says:

> Nothing indicates that Wells Fargo 'manipulated' the arbitrator pool. It simply asked that [Arbitrator] Pinckney be removed under FINRA Rule 12407. We fail to see how the Director's decision to grant that request — which was made after all parties had a chance to address the issue — constituted manipulation by Wells Fargo.[] Although the investors claim that a 'secret agreement' existed between FINRA and Weiss to automatically exclude the *Postell* arbitrators from any arbitrator list generated on a case involving Weiss, there is no evidence that such agreement was at play here, given Pinckney's inclusion on the initial list. Even if an agreement exists, the investors have not shown that it impacted this arbitration."

Appeal to Georgia Supreme Court Filed ... and Denied

Our past editorial comment was: "Dare we say it? Barring further appeals, this might be the end of this one …." Alas, as reported in SAA 2022-42 (Nov. 10), Leggett on **August 22, 2022** filed a Petition for *Certiorari,* seeking review by the Georgia Supreme Court. On **April 4,** a unanimous Court declined to review the case, stating: "Certiorari – Writ denied …. All the Justices concur, except Boggs, C. J., not participating."

Outside Investigator's Report

As summarized in SAA 2022-38 (Oct. 13), FINRA on **June 29, 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.

Recommended Changes

After discussing methodology and the operation of the Neutral List Selection System, the Report concluded that there were no irregularities, and it closed with recommendations for improvement. The core recommendations were (*ed: presented* verbatim *from the Release*):

> • Implementing ongoing, mandatory training for staff;
> • Requiring written explanations, upon a party's request, of approval or denial of a causal challenge to the selection of an arbitrator or an arbitrator removal by the DRS Director for cause;
> • Conducting an updated external procedural review of the arbitrator selection algorithm to determine if it is still the most effective means for creating random, computer-generated arbitrator lists; and
> • Updating the DRS Manual and rules to clarify staff roles and procedures, and to ensure consistency and transparency.

FINRA's Follow-up: A Dedicated Webpage with Status Indicated

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 seven items have been implemented and the rest are "in progress." We present the "completed" information below essentially *verbatim*, as of **June 7**:

Recommendation 1

a. Update the DRS Procedures Manual ("PM") to include a Code of Neutrality to codify the standards that DRS personnel are expected to maintain in their interactions with DRS participants and execution of their job duties.
Status: Complete. Implemented on November 14, 2022.

b. Update the PM to clarify the job title responsible for each of the procedures identified in the PM.
Status: Complete. Implemented on November 17, 2022.

c. Update the PM to clarify the duties and responsibilities of DRS managers and supervisors to ensure that the PM is being followed, including the types of audits and reviews that should be completed and how often.
Status: Complete. Implemented on October 15, 2022.

d. Update the PM to clearly identify the job title or, if it is the Director, his or her designee, that has authority to provide final approval when a decision is required.
Status: Complete. Implemented on December 6, 2022.

e. Update the PM to clarify the information, including the expected level of specificity, that should be entered into the Mediation and Arbitration Tracking and Retrieval Interactive Case System ("MATRICS") when required.
Status: Complete. Implemented on November 28, 2022.

Recommendation 5

a. Establish a policy whereby DRS will provide a written explanation every time a challenge, or a party's request to remove an arbitrator, is decided.
Status: Complete. Implemented on September 1, 2022. A footnote adds: "The independent counsel recommended that DRS consider amending its policies to require a written explanation whenever a challenge is granted or denied, if a written explanation is requested by either party. DRS will be expanding this recommendation and will provide a written explanation every time a challenge is decided regardless of whether a party makes the request."

Recommendation 7

Amend FINRA Rules to refer to MATRICS instead of NLSS.
Status: On September 15, 2022, FINRA filed an immediately effective rule filing with the SEC changing the reference in the Codes from "NLSS" to "List Selection Algorithm."

*(ed: *Kudos to FINRA for this transparency. **Neutral Corner volume 2023-1 features a page-one story on this topic.)*
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SHORT BRIEFS: CONCISE NEWS YOU NEED TO KNOW

FINRA PUBLISHES 2022 FINE DATA REPORT. HARD TO DETERMINE DRS' PIECE OF THE PIE, BUT IT LOOKS SMALL. FINRA on **May 31** published information on how it uses fine money. *Report on Use of 2022 Fine Monies* shows that the Authority in 2022 levied $48.1 million in fines, down from $57 million in 2021. What was Dispute Resolution Services' slice of the fine money pie? Hard to say. The sole reference to DRS states in the *Registration, Testing and Corporate Systems Enhancements* section: "FINRA invested $4.1 million to transform and enhance its registration and testing systems. In 2022, investments included costs to transform the qualification exam platform, enhance our registration system to more efficiently process 2080 waivers and data input by firms, automate accounts governance, *and enhance our Testing and Dispute Resolution programs*" (emphasis added). Investor ed garnered $4.2 million, although the Report notes that the FINRA Foundation is separately funded.

*(ed: "Fines-eligible" expenditures were $111.4 million. **As we've said before, this is a welcome development in aid of transparency.)*
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GEORGIA STRENGTHENS ELDER ABUSE INVESTOR PROTECTIONS. Georgia Governor **Brian Kemp** on **May 3** signed into law SB 84, which amended Chapter 5 of Title 10 of the *Georgia Uniform Securities Act of 2008*: "to provide for financial protections for elder and disabled adults who may be victims of financial exploitation; to provide for reporting and notice requirements; to provide for the delay of disbursements or transactions that may result in such financial exploitation; to provide for civil and administrative liability protections; to provide for certain disclosures and access to records; to provide for limitations; to provide for definitions; to provide for related matters; to repeal conflicting laws; and for other purposes." A **May 23** *JD Supra* article by **Taylor Bandy** of Bressler, Amery & Ross, P.C., *Georgia Enacts Broker-Dealer and Investment Adviser Financial Exploitation Law*, offers this description: "The new law… requires broker-dealers and state-registered investment advisers to report suspected financial exploitation to the Commissioner. Firms are also allowed, but not required, to contact third parties previously designated by the eligible adult.[] Georgia's law also permits firms to delay disbursements or transactions from an account owned by an eligible adult or an account on which an eligible adult is a beneficiary if certain conditions are met. Firms that take action pursuant to these provisions in good faith and exercising reasonable care are granted civil and administrative immunity."
*(ed: *There is no mention of arbitration. **The new law goes into effect on July 1, 2023.)*
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N.J. APPELLATE COURT HOLDS FREE-STANDING CLASS ACTION WAIVER UNENFORCEABLE. The law is well-settled that a class action waiver in a predispute arbitration agreement ("PDAA") is generally enforceable, but what about a free-standing class action waiver that's not part of a PDAA? "Not enforceable," says a unanimous court in *Pace v. Hamilton Cove*, No. A-0674-22 (N.J. Super. Ct., App. Div. May 18, 2023). The Court notes that the precedents favoring class action waivers drew their essence from enforcing PDAAs under the Federal Arbitration Act: "Here, in contrast, there was no agreement to arbitrate contractual disputes. Plaintiffs and the other tenants were free to litigate their contractual and fraud claims in court. Therefore, the policies favoring arbitration and encouraging enforcement of arbitration agreements, as expressed in section 2 of the FAA, see *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984), or the New Jersey Arbitration Act, N.J.S.A. 2A:23B-1 to -36, see *Roach v. BM Motoring*, LLC, 228 N.J. 163, 173-74 (2017), do not apply and what the Supreme Court of the United States has said about class action waivers – because it was all intended to enhance the FAA's arbitration policies – is irrelevant outside that context. Instead, New Jersey's public policy favoring class actions … applies."
(ed: Seems right.)
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QUICK TAKES: CASES AND AWARDS WORTH READING

***Green Enterprises, LLC v. Hiscox Syndicates Limited at Lloyd's of London*, No. 21-1542 (1st Cir. May 19, 2023)**: "As we will explain, this appeal presents a question of first impression in this circuit that turns on the interactions among Puerto Rico law, two federal statutes, and a multilateral treaty to which the United States is a party. For the following reasons, we affirm the judgment of the district court granting Underwriters' motion to compel arbitration and dismissing Green's claims without prejudice."

***Women's Care Specialists, P.C. v. Potter*, Nos. 2022-0706, 2022-0707 (Ala. May 19, 2023)**: "In short, the arguments concerned whether Potter's claims are within the scope of the arbitration provision, whether the arbitration provision continued to apply after the 'termination' of her employment, and when that termination occurred. The trial court entered an order denying those motions. Women's Care (appeal no. SC-2022-0706) and the WC employees (appeal no. SC-2022-0707) separately appealed; this Court consolidated the appeals. For the reasons stated below, in appeal no. SC-2022-0706, we reverse the trial court's order denying Women's Care's motion to compel arbitration. In appeal no. SC-2022-0707, we reverse the trial court's order denying the WC employees' motion to compel arbitration."

***Jack v. Ring LLC*, No. A165103 (Calif. Ct. App. 1 May 25, 2023)**: "Brandon Jack and Jean Alda (together, plaintiffs) purchased video doorbell and security camera products from Ring and subsequently filed a class action complaint against Ring asserting claims under various consumer protection statutes. In their lawsuit, plaintiffs seek injunctive relief requiring Ring to prominently disclose to consumers certain information about its products and services.[] Ring moved to compel arbitration based on an arbitration provision in its terms of service. Opposing the motion, plaintiffs did not dispute that they agreed to Ring's terms of service, but they argued the applicable arbitration provision violates the California Supreme Court's holding in *McGill v. Citibank, N.A.* (2017) 2 Cal.5th 945, 961 (*McGill*) that a predispute arbitration agreement is invalid and unenforceable under state law insofar as it purports to waive a party's statutory right to seek public injunctive relief. The trial court denied the motion to compel arbitration, and Ring appeals. We affirm." (*ed: An* Alert *h/t to Editorial Board member Peter R. Boutin, Esq., of Keesal, Young & Logan, for alerting us to this decision.*)

***Merrill Lynch v. Rowen*, FINRA ID No. 23-00171 (Los Angeles, CA, Apr. 13, 2023)**: In this big dollar case, a non-appearing broker is held liable to Claimant for over $1.5 million in damages relating to monies owed pursuant to the terms of two executed promissory notes. *Provided courtesy of SAC's ARBchek facility (www.arbchek.com).*

***Armour Self Storage v. TD Ameritrade*, FINRA ID No. (Phoenix, AZ, Apr. 19, 2023)**: A group of customers alleging negligence with respect to their purchase of iRhythm Technologies Inc. and seeking $15,000,000 in punitive damages, lose their case against Respondent broker-dealer. *Provided courtesy of SAC's ARBchek facility (www.arbchek.com)*

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Giorgetti, Chiara, *Habemus Codicem! UNCITRAL WGIII Agrees on Final Versions of Codes of Conduct for Arbitrators and Judges in ISDS*, Kluwer Arbitration Blog (May 28, 2023): "With 17 minutes to spare before the end of the 45th Session, the chair of UNCITRAL Working Group III (WGIII), Mr Spelliscy, announced that a workable compromise had been reached on the last remaining outstanding issue (how to regulate double hatting) and that, therefore, an agreement was reached on a text of the *Code of Conduct for Arbitrators in Investor-State Dispute Settlement* (ISDS) to be presented for final approval at the UNCITRAL Commission in July 2023.[] This is a significant development for the ISDS reform process which and has long been coming. The development of a *Code of Conduct for Adjudicators in ISDS* (more on the reason of the code's change of title below) has been part of WGIII's reform process since its inception in 2017. After consultations, in October 2019, WGIII requested the UNCITRAL Secretariat, together with the Secretariat of ICSID, to prepare a draft Code for Adjudicators, and the Secretariats released the first draft of the Code for discussion in May 2020…."

***Wells Fargo FA Can Erase "Fairly Sophisticated" Client's Unsuitability Claim*, Financial Advisor IQ (May 26, 2023)**: "A Wells Fargo advisor has been granted expungement of a customer complaint alleging unsuitability and a failure to mitigate losses in an investment account, according to an arbitration decision published this week by the Financial Industry Regulatory Authority.[] Scottsdale, Arizona–based [adviser], who has been with Wells Fargo Advisors since 2015, had been managing an account for 'a fairly sophisticated investor,' a trial attorney with years of investing experience who also maintained self-directed investing accounts, according to an arbitration decision published by Finra this week."

***How FINRA Spent its Enforcement Fines*, Investment Executive (May 31, 2023)**: "Enforcement fines levied by the U.S. Financial Industry Regulatory Authority Inc. (FINRA) last year contributed US$48.1 million to the self-regulatory organization's spending on an array of initiatives.[] In a new report, FINRA outlined how it used the money collected from enforcement fines in 2022…. In 2022, the FINRA board identified US$111.4 million worth of spending that could be funded by enforcement fines. Spending included US$89.2 million on capital initiatives or non-recurring strategic expenditures to improve compliance and bolster regulatory oversight, and US$22.2 million on investor and industry compliance education.[] Given that the eligible spending exceeded the fines handed out, the balance of those expenditures (US$63.3 million) was funded from FINRA's reserves and operating budget, it said." (*ed: See our coverage elsewhere in this* Alert.)

***The Rise of a New FINRA Risk & How to Navigate It*, Corporate Compliance Insights (May 31, 2023)**: "Broker-dealers face increasing risks tied to a 2019 regulation that had previously flown under the radar: Regulation Best Interest — Reg BI for short. Both the SEC and the Financial Industry Regulatory Authority (FINRA) took their first

disciplinary actions to enforce the regulation last year. In addition, the number of claims customers filed alleging a Reg BI violation surged last year, increasing faster than any other type of FINRA arbitration claim."

***Vanguard Fined for Providing Misleading Account Statements to its Customers*,** **Reuters (Jun. 1, 2023)**: "Vanguard Group, the world's largest issuer of mutual funds, was fined and censured by the Financial Industry Regulatory Authority (FINRA) for errors appearing in about 8.5 million customer account statements.[] FINRA, Wall Street's self-regulatory organization, said in a filing signed last month by representatives of both parties that Vanguard overstated projected yield and projected annual income for nine money market funds from November 2019 to September 2020. It ordered Vanguard to pay a fine of $800,000."

***Securities Industry Arbitrations and Litigation Update: FINRA Member Firms Don't Forget to "Dot Your I's and Cross Your T's" in Seeking to Confirm Promissory Note Arbitration Award*, Lexology (Jun. 2, 2023)**: "As any Wall Street litigator knows, in the securities industry, it is typical for brokerage firms to incentivize their employed financial advisers with significant upfront compensation at the beginning of a relationship or even at the beginning of each new financial year. These up-front payments are often structured as 'forgivable loans' and memorialized in promissory notes. However, if the employment relationship ends prematurely or the financial advisor fails to meet certain objectives and obligations such as revenue goals, repayment obligations can be triggered. Not surprisingly, litigation stemming from these promissory notes is commonplace before the Financial Industry Regulatory Authority (FINRA) in its arbitral forum, and these arbitrations only increase in volume as we step into more turbulent economic times when layoffs and resignations become commonplace in the industry." (*ed: We plan to analyze this case in a future* Alert.)

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DID YOU KNOW?

GROVER CLEVELAND AND THE VENEZUELAN CRISIS OF 1895. Arbitration over the years has been used to resolve disputes between nations and sometimes to avert war. In SAA 2023-20 (May 25), we covered the *Alabama Claims of 1862 – 1872*, where arbitration was used to resolve successfully Civil War claims asserted by the United States against England. Another case in point is the *Venezuelan Crisis of 1895*, which was a border dispute between the United Kingdom and Venezuela. About what? According to Wikipedia, it had something to do with: "Britain's refusal to include in a proposed international arbitration the territory east of the 'Schomburgk Line', which a surveyor had drawn half a century earlier as a boundary between Venezuela and the formerly Dutch territory of British Guiana." The real fight was about gold. The dispute escalated into a major crisis with the possibility of armed conflict, and **President Grover Cleveland,** citing the Monroe Doctrine, intervened to compel the parties to arbitrate the dispute. The countries ultimately agreed to a five-member arbitration panel, consisting of two arbitrators chosen by the U.K., two representing Venezuelan interests – but named by the U.S. – and the neutral chair to be selected by these four arbitrators. The two

arbitrators selected by the U.S. were the sitting Chief Justice and an Associate Justice of the Supreme Court, and the chair was a Russian judge and diplomat. The tribunal ultimately held hearings in Paris in 1898, and a year later ruled largely in favor of the Brits. Former **President Benjamin Harrison** represented Venezuela in the arbitration. *return to top*

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