SECURITIES ARBITRATION ALERT 2024-09 (2/29/24)

George H. Friedman, Editor-in-Chief

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DID YOU KNOW?

- **Truth is Stranger than Fiction**

SCOTUS HEARS ORAL ARGUMENT IN *SUSKI*. *The Supreme Court heard oral argument February 28 in* Coinbase v. Suski, *No. 23-3, the second case involving arbitration heard this month. The other case is* Bissonnette v. LePage Bakeries Park St. LLC, *No. 23-51, which was heard February 20* (*ed: see our February 21 blog post*). *The* Suski *audio is here and the transcript can be found here. We will cover this topic in detail in the next* Alert.

SQUIBS: IN-DEPTH ANALYSIS

SEC "UN-APPROVES" – SORT OF – FINRA'S CHANGES TO NON-ATTORNEY REP RULE. ***The SEC has temporarily walked back its January 2024 approval of FINRA's proposal to amend the non-attorney representation rules.*** As reported in SAA 2023-40 (Oct. 26), the authority on **October 5, 2023,** filed SR-FINRA-2023-013, *Proposed Rule Change to Amend the Codes of Arbitration Procedure and Code of Mediation Procedure to Revise and Restate the Qualifications for Representatives in Arbitrations and Mediations.* The text states that the intent is to amend the Codes to (*ed: repeated* verbatim*; bullet format added*):

- revise and restate the qualifications for representatives in arbitrations and mediations in the forum administered by FINRA Dispute Resolution Services ('DRS');
- disallow compensated representatives who are not attorneys from representing parties in the DRS forum;
- codify that a student enrolled in a law school participating in a law school clinical program or its equivalent and practicing under the supervision of an attorney may represent investors in the DRS forum; and
- clarify the circumstances in which any person, including attorneys, would be prohibited from representing parties in the DRS forum.

Rule Filing Published; Few Comments Received; Rule Approved

The proposal was published in the *Federal Register* on **October 13, 2023**, (Vol. 88, No. 197. P. 71051). Our editorial comment in no. 40 – "We imagine there will be many comments!" – was way off. Just five generally supportive comments were received, including letters from **PIABA** and the **St. John's** Securities Arbitration Clinic. FINRA filed a two-page **January 8** response to comments, urging approval. As reported in SAA 2024-03 (Jan. 18), and as we blogged in January, the SEC under delegated authority approved the rule changes in a 17-page **January 11** Order.

Bolt from the Blue

Our editorial comment in no. 03 was: "Next is publication by FINRA of a Regulatory Notice setting the effective date." It turn out we were overly optimistic. In following up, we came across a **January 19** "Notice of Review and Stay" from the Commission to FINRA, that reads in pertinent part: "On January 11, 2024, the Division of Trading and Markets took action, pursuant to delegated authority, 17 CFR 200.30-3(a)(12), approving the proposed rule change by FINRA to amend the FINRA Codes of Arbitration Procedure and Code of Mediation Procedure. Order Approving Proposed Rule Change to Amend the FINRA Codes of Arbitration Procedure and Code of Mediation Procedure to Revise and Restate the Qualifications for Representatives in Arbitrations and Mediations, Securities Exchange Act of 1934 Release No. 99335 (January 11, 2024).[] This letter is to notify you that, pursuant to Rule 431 of the Commission's Rules of Practice, 17 CFR 201.431, the Commission will review the delegated action. In accordance with Rule 431(e), the January 11, 2024 order is stayed until the Commission orders otherwise." *(ed: Wow. We've never seen this before.)*

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CALIFORNIA COURT DEFINES "DISPUTE" IN *EFASASHA*. *A California appellate court rules that the* Ending Forced Arbitration of Sexual Assault and Sexual Harassment Act *("Act" or "EFASASHA") can be applied retroactively, where employee's claim was asserted after the law's effective date.* As we have reported many times, **President Biden** on **March 3, 2022** signed the *Ending Forced Arbitration of Sexual Assault and Sexual Harassment Act of 2021*, which expressly amended the Federal Arbitration Act ("FAA") to make this class of predispute arbitration agreements ("PDAAs") voidable at the option of the victim. The new law was codified as FAA Chapter 4 and consists of § 401 (definitions) and § 402 (no validity or enforceability).

Troublesome Language

The law was effective immediately for: "any dispute or claim that arises or accrues on or after the date of enactment of this Act." From the start, we've been concerned about this aspect of the Act. For example, assuming the employment agreement is governed by a PDAA signed before March 3, 2022: 1) When exactly does a claim "accrue"? 2) What if a case is filed after March 3, 2022, but the acts giving rise to the claim happened before that date? What if the events are ongoing and straddle March 3, 2022? As we've said before, SCOTUS has ruled several times that arbitration agreements are separate contracts. Does a law allowing retroactive nullification of existing PDAAs invite legal challenges based on the Constitution's Takings Clause?

A Case in Point

Some of these issues were front and center in *Kader v. Southern California Medical Center, Inc.*, No. B326830 (Calif. Ct. App. 2 (Jan. 29, 2024). What happened? "An employee signed an arbitration agreement with his employer in the regular course of his employment, without disclosing that he was being subjected to sexual harassment and assault…. Following the effective date of the Act, the employee sued the employer and other defendants for claims arising from the alleged sexual conduct. The defendants filed a motion to compel arbitration, which the trial court denied based on the Act. On appeal, the defendants contend the Act does not invalidate the arbitration agreement in this case because the alleged sexual conduct constituted a 'dispute,' which preexisted the parties' arbitration agreement and the effective date of the Act."

EFASASHA Can Be Applied Retroactively Here

The Court holds that, based on the facts of the case, EFASASHA can invalidate the PDAA because the "dispute" arose after the Act's effective date: "We conclude the date that a dispute has arisen for purposes of the Act depends on the unique facts of each case, but a dispute does not arise merely from the fact of injury. For a dispute to arise, a party must first assert a right, claim, or demand. There is no evidence of a disagreement or controversy in this case until after the date of the arbitration agreement and the effective date of the Act, when the employee filed charges with the Department of Fair Employment and Housing (DFEH) in May 2022.1 Therefore, the predispute arbitration agreement is invalid, and the order denying the motion to compel arbitration is affirmed."

*(ed: *We covered similar cases in the past with mixed results. See Zuluaga v. Altice USA, No. A-2265-21 (N.J. App. Div. 2022) (per curiam), in SAA 2022-47 (Dec. 15) and Barnes v. Festival Fun Parks, LLC, No. 3:22-cv-00165 (W.D. Pa. Jun. 27, 2023), in SAA 2023-28 (Jul. 27). **The core question in our mind remains to be decided by SCOTUS: can EFASASHA be applied to retroactively invalidate an existing PDAA where the claim clearly arises after March 3, 2022?)*
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SHORT BRIEFS: CONCISE NEWS YOU NEED TO KNOW

REMINDER: FINRA'S RULE CHANGES IMPLEMENTING ARBITRATOR SELECTION INVESTIGATION REPORT RECOMMENDATIONS GO INTO EFFECT MARCH 4. FINRA on **February 6** published Regulatory Notice 24-03, *Amendments to the Arbitration Codes to Make Various Clarifying and Technical Changes*. It states: "FINRA has amended its Codes of Arbitration Procedure (Codes) to make: (1) changes to the arbitrator list selection process in response to recommendations in the report of independent counsel Lowenstein Sandler LLP (Report) and (2) 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." The amendments are effective for arbitration cases filed on or after **March 4**.
(ed: We covered the subject in detail in a February 14 blog post.)
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FINRA BOARD MEETS IN PERSON NEXT WEEK. FINRA's Board of Governors is meeting in person **March 6–7**. The Agenda has not yet been published. The rest of the **2024** schedule is: May 8–9; July 24–25; September 18–19; and December 4–5.
(ed: As usual, we will follow up after the meeting results are released.)
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SEC'S INVESTOR ADVISORY COMMITTEE MEETS MARCH 7. NO ARBITRATION OR MEDIATION ITEMS ON THE AGENDA. The SEC's Investor Advisory Committee ("IAC") will be meeting virtually **March 7**. There are no dispute resolution items on the Agenda.
*(ed: *The minutes of the December 7 meeting are not yet posted. **The IAC meeting will be Webcast starting at 10:30 a.m. Eastern on the Commission's Website at www.sec.gov. ***For further info, "and to ascertain what, if any, matters have been added, deleted or postponed," contact Vanessa A. Countryman at 202-551-5400.)*
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NFA INVESTOR NEWSLETTER HITS THE ELECTRONIC NEWSSTAND. The National Futures Association ("NFA"), which operates a dispute resolution forum, issues a periodic *Investor Newsletter* aimed at commodity futures investors. It's designed to keep investors up to date on recent NFA initiatives, events, and resources that investors may find helpful. In the first *Newsletter* of **2024**, distributed under a summary email dated **February 15**, NFA lists several highlights which we explore in the order presented:

Investor Education reports on: *National Consumer Protection Week*: "The Federal Trade Commission's (FTC) National Consumer Protection Week will take place from March 3 to March 9, 2024, with the goal of helping people understand their consumer rights and avoid frauds and scams. To support this initiative, the FTC has free resources available for order and encourages the investing public to subscribe to its consumer alerts." The **Investor Protection** section contains three items: a joint SEC/FINRA/NASAA Investor Alert, *Artificial Intelligence (AI) and Investment Fraud*; a FINRA Investor Alert, *Social Media "Investment Group" Imposter Scams on the Rise*; and a CFTC Customer Advisory, *AI Won't Turn Trading Bots into Money Machines*. As usual, the *Newsletter* signs off with a list of the quarter's enforcement actions, with links to final decisions in each, complaints that were issued, and final orders in registration cases. The *Newsletter* Webpage also contains: 1) a link to BASIC; 2) an online complaint form; 3) a link to past issues of the *Newsletter* and 4) a subscription form.
*(ed: *Another informative issue. **The enforcement actions database allows searches by subject matter, such as arbitration. ***Stats may be found here.)*
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QUICK TAKES: CASES AND AWARDS WORTH READING

***Smartsky Networks, LLC v. DAG Wireless, LTD.*, No. 22-1253 (4th Cir. Feb. 13, 2024)**: "In *Badgerow*, the Supreme Court held that a federal district court faced with an application to enforce or vacate an arbitration award under Sections 9 or 10 of the Federal Arbitration Act, 9 U.S.C. §§ 1, et seq. (the 'FAA'), must have a basis for subject matter jurisdiction independent from the FAA and apparent on the face of the application. The Court further held that 'look-through' jurisdiction only applies to petitions to compel arbitration under Section 4 of the FAA, and that such jurisdiction is not available for Section 9 and 10 applications. In accordance with these holdings in *Badgerow*, we find that the district court did not have an independent basis of subject matter jurisdiction to confirm the arbitration award; and reverse and remand to the district court for further proceedings consistent with our opinion."

***Coatney v. Ancestry.com DNA, LLC,* No. 22-2813 (7th Cir. Feb. 15, 2024)**: "Ancestry.com sells genealogy tools to aid users in researching their family history. Registered users of its website must first agree to an arbitration clause. In this case, guardians activated DNA test kits through their accounts on behalf of their children. Those children are the plaintiffs here. When another business acquired Ancestry, the plaintiffs contended that Ancestry violated their privacy rights by disclosing confidential genetic information and sued. Ancestry moved to compel arbitration.[] Sitting in diversity and applying Illinois law, the district court ruled that the plaintiffs were not bound to arbitrate their claims under an agreement between their guardians and Ancestry. We agree and affirm the decision of the district court."

***Johnson v. Lowes Home Centers, LLC*, No. 22-16486 (9th Cir. Feb. 12, 2024)**: "Relying on the U.S. Supreme Court's interpretation of PAGA in *Viking River Cruises, Inc. v. Moriana*, 596 U.S. 639 (2022), the district court dismissed Johnson's nonindividual PAGA claims. While this case was on appeal, the California Supreme

Court in *Adolph* corrected *Viking River's* interpretation of PAGA, holding that a PAGA plaintiff can arbitrate his individual PAGA claim but at the same time maintain his non-individual PAGA claims in court. The panel therefore vacated the district court's order with respect to the non-individual PAGA claims and remanded to the district court to apply *Adolph*. The panel rejected Lowe's contention that *Adolph* was inconsistent with *Viking River."*

***Frey v. Charles Schwab*, FINRA ID No. 23-02316 (Los Angeles, CA, Jan. 22, 2024)**: In this small claims arbitration, a customer loses his case relating to the execution of a limit order of S&P 500 Mini SPX Options Index puts." *Provided courtesy of SAC's ARBchek facility (www.arbchek.com).*

***Warshaw v. American Portfolios*, FINRA ID No. 23-02255 (New York, NY, Jan. 24, 2024)**: A Panel denies Claimant broker's request for expungement of a customer complaint from his CRD record, after finding that the claim was not factually impossible or clearly erroneous under Rule 2080 section (A). The monies were distributed from the Trust account in violation of the Trust document and without clear countervailing instructions from the Trust's Trustees. *Provided courtesy of SAC's ARBchek facility (www.arbchek.com).*
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ARTICLES OF INTEREST: RECENT NEWS FROM THE ADR FRONT

James Plant and Brooke Gilbey, *Countdown to RIDW24: The Role of Experts and Lawyers in Arbitration*, Kluwer Arbitration Blog (Feb. 17, 2024): "Expert witness evidence plays a pivotal role in the outcome of arbitrations, particularly in construction disputes. Rarely do construction disputes turn on significant differences between the parties' versions of the facts, which are flushed out under dramatic, Boston Legal-style cross-examination. More often, it is the skilful [sic] application of settled facts by the parties' legal counsel and experts that wins the day."

***FINRA Fines Morgan Stanley $1.6 Million for Municipal Securities Violations and Related Failures*, www.finra.org (Feb. 15, 2024)**: "FINRA announced today that it has fined Morgan Stanley Smith Barney LLC $1.6 million for the firm's repeated failures to timely close out failed inter-dealer municipal securities transactions and to take prompt steps to obtain physical possession or control of municipal security positions that are short more than 30 calendar days, and related supervisory failures. This is the first disciplinary action in which FINRA has charged a firm with violating the close-out requirements of Municipal Securities Rulemaking Board (MSRB) Rule G-12(h) and related supervisory failures. FINRA previously sanctioned Morgan Stanley for supervisory failures regarding short positions in municipal securities in 2015."

***FINRA Violation Defense Strategies*, National Law Review (Feb. 15, 2024)**: "Violations of the Financial Industry Regulatory Authority (FINRA) Rules are more than just customer complaints. It can present substantial risks for brokerage firms and individual broker-dealers. Along with monetary fines, broker misconduct, and FINRA

Rule violations can also lead to suspensions—and even bars from the securities industry in extreme cases. FINRA enforcement actions are set to prevent broker misconduct. It can lead to scrutiny from the U.S. Securities and Exchange Commission (SEC) as well, and investors may also use FINRA's findings to pursue claims in arbitration.[] As a result, when facing allegations of Rule violations from FINRA, brokerage firms and broker-dealers must assert vigorous and comprehensive defenses. Here are seven examples of defense strategies a registered firm, other firm representatives, and broker-dealers can use in these cases."

***Gensler Sticking to SEC Agenda Despite Upcoming Election*, Financial Advisor IQ (Feb. 15, 2024)**: "Despite the possibility of a new Republican majority in the government hampering the Securities and Exchange Commission's rulemaking agenda come November, Chair Gary Gensler has no plans to rush any of the work, according to news reports.[] The agency has pushed through close to three dozen rules under the administration of President Joe Biden, but it still has around 20 left to do, and many of them are not popular with conservative Republicans, Bloomberg writes. If Republicans gain more political power this fall, any regulation not completed over the next few months could be killed via a 'congressional maneuver,' according to the news service."

***SEC Publishes Annual Staff Report on Nationally Recognized Statistical Rating Organizations*, www.sec.gov (Feb. 16, 2024)**: "The Securities and Exchange Commission's Office of Credit Ratings published its annual Staff Report to Congress today on Nationally Recognized Statistical Rating Organizations (NRSROs), commonly known as credit rating agencies, to provide findings on its examinations of the agencies, and to discuss the state of competition, transparency, and conflicts of interest among them."

***Federal Case Challenges Mass Arbitration "Shakedown" Amid Recent Amendments to AAA Rules*, JDSupra (Feb. 16, 2024)**: "A recent complaint against plaintiffs' firm Zimmerman Reed directly challenges the law firm's mass arbitration tactics and alleged 'weaponization' of a California privacy statute. The complaint comes as arbitration authorities grapple with how to handle the influx of mass arbitration, including the American Arbitration Association's ('AAA') recent amendments to its newly branded Mass Arbitration Supplementary Rules."

***SEC Charges TIAA Subsidiary for Failing to Act in the Best Interest of Retail Customers*, www.sec.gov (Feb. 16, 2024):** "The Securities and Exchange Commission today announced that registered broker-dealer TIAA-CREF Individual & Institutional Services LLC (TC Services), a subsidiary of Teachers Insurance and Annuity Association of America (TIAA), will pay more than $2.2 million to settle charges that it failed to comply with Regulation Best Interest (Reg BI) in connection with recommendations to retail customers to open a TIAA Individual Retirement Account (TIAA IRA)."
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DID YOU KNOW?

TRUTH IS STRANGER THAN FICTION. The Los Angeles Housing Department, which among other things runs a dispute resolution program for eviction conflicts, was itself evicted from its offices, according to media reports: "The Los Angeles Housing Department (LAHD) has closed its main office at 1200 West Seventh Street after its landlord opted to lease the whole building to a different tenant…. The LAHD typically mediates disputes between renters and landlords, including those over living conditions, harassment, rent increases, and evictions. But it currently finds itself in the same position as the aggrieved tenants who often visit its now-shuttered public counter at the Seventh Street office."

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