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## The Expungement of Customer Complaint CRD Information Following the Settlement of a FINRA Arbitration

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# The Expungement of Customer Complaint CRD Information Following the Settlement of a FINRA Arbitration\*

Seth E. Lipner

## Abstract

The Financial Industry Regulatory Association (“FINRA”) maintains a database of customer complaints regarding individuals licensed by FINRA as registered representatives. Both securities regulators and the investing public can access and use the data to find out about past customer complaints of the registered representatives. However, records of customer complaints can be expunged from the database through an arbitration process that FINRA created. This Article traces the history of that arbitration process and focuses on how it is employed in cases where the investor was paid money to settle a claim. The Article studies FINRA arbitrations in such cases and reveals that customer complaints regarding claims that later settled are being expunged at the rate of 93.7%, often in perfunctory ex parte proceedings where the complainant has agreed to not oppose the application as part of the settlement. This Article concludes with a proposal for necessary changes to the expungement process in order for the FINRA database to maintain its integrity.

**KEYWORDS:** FINRA, Arbitration, Alternative Dispute Resolution, Securities, Regulation, Investing

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\*Professor of Law, Zicklin School of Business, Baruch College. The Author thanks Kirill Kan for his detailed legal research and insights and Gregory Draves, Zoe Lipner, and Gisela Rubenstein for their assistance with the award research that underlies this piece.



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## ABSTRACT

The Financial Industry Regulatory Association (“FINRA”) maintains a database of customer complaints regarding individuals licensed by FINRA as registered representatives. Both securities regulators and the investing public can access and use the data to find out about past customer complaints of the registered representatives. However, records of customer complaints can be expunged from the database through an arbitration process that FINRA created.

This Article traces the history of that arbitration process and focuses on how it is employed in cases where the investor was paid money to settle a claim. The Article studies FINRA arbitrations in such cases and reveals that customer complaints regarding claims that later settled are being expunged at the rate of 93.7%, often in perfunctory ex parte proceedings where the complainant has agreed to not oppose the application as part of the settlement. This Article concludes with a proposal for necessary changes to the expungement process in order for the FINRA database to maintain its integrity.

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\* Professor of Law, Zicklin School of Business, Baruch College. The Author thanks Kirill Kan for his detailed legal research and insights and Gregory Draves, Zoe Lipner, and Gisela Rubenstein for their assistance with the award research that underlies this piece.

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### INTRODUCTION

The Financial Industry Regulatory Authority (“FINRA”) maintains the Central Registration Depository (“CRD”), a database of information about individuals registered as representatives of securities brokerage firms.<sup>1</sup> The CRD profile of a registered representative contains information about, inter alia, un-adjudicated complaints and pending arbitrations brought by investor-customers.<sup>2</sup> CRD is important because of its potential value to regulators, prospective employers of the individual, and the investing public in overseeing, hiring, or choosing registered representatives.<sup>3</sup> “BrokerCheck,” the online system that makes this information publicly available, draws its data from CRD.<sup>4</sup>

The reporting and public availability of un-adjudicated customer complaints affects the reputation of registered representatives, and that

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1. See *Central Registration Depository (CRD)*, FINRA, <http://www.finra.org/Industry/Compliance/Registration/CRD/index.htm> (last visited June 16, 2013).

2. *Id.*

3. See NASD, NOTICE TO MEMBERS 01-65: NASD SEEKS COMMENT ON PROPOSED RULES AND POLICIES RELATING TO EXPUNGEMENT OF INFORMATION FROM THE CENTRAL REGISTRATION DEPOSITORY, at 564 (2001), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p003745.pdf> [hereinafter NASD, NTM 01-65].

4. See *BrokerCheck – Search*, FINRA, <http://brokercheck.finra.org/Search/Search.aspx> (last visited Nov. 1, 2013); *About BrokerCheck Reports*, FINRA, <http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/> (last visited Nov. 1, 2013).

causes concern among industry participants.<sup>5</sup> Industry participants oppose the disclosure and public availability of un-adjudicated complaints, asserting that unproven information could damage reputations.<sup>6</sup> FINRA, however, has not shown any inclination to eliminate such reporting.<sup>7</sup>

FINRA does, however, offer a process by which any broker whose CRD profile is affected by a customer complaint may apply to a FINRA arbitration panel to expunge that information from the database.<sup>8</sup> This arbitration process creates little controversy when the investor's claim is dismissed after a merits-based hearing in which both the complainant and the broker appear.<sup>9</sup> In those cases, the arbitrators who heard the evidence are well positioned to decide whether the record should be expunged, e.g., by concluding that the expungement request has merit.<sup>10</sup>

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5. See Dan Jamieson, *In re, BrokerCheck: SIFMA Urges FINRA to Expand In Re Expungement*, INVESTMENT NEWS (May 25, 2012, 3:04 PM), <http://www.investmentnews.com/article/20120525/FREE/120529939#>.

6. See *id.*

7. See, e.g., *SIFMA Comment to FINRA Regulatory Notice 12-18 (FINRA Requests Comment on Proposed New In re Expungement Procedures for Persons Not Named in a Customer-Initiated Arbitration)*, <http://www.finra.org/Industry/Regulation/Notices/2012/P125948> (last visited June 16, 2013) [hereinafter SIFMA, COMMENT LETTER] (“Throughout the development of these disclosure requirements, and while recognizing the positive goal of promoting informed investor decision-making, SIFMA has cautioned against disclosure requirements that do not advance the goal of providing relevant information and, worse, risk the dissemination of unfounded negative information that can have an adverse impact on a registered person’s business and reputation.”).

8. See *Expungement*, FINRA, <http://www.finra.org/arbitrationandmediation/arbitration/specialprocedures/expungement/> (last visited June 16, 2013).

9. See Florence Harmon, Letter of FINRA to SEC, at 2 n.8 (Sept. 3, 2008) <http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p039154.pdf>; Order Approving a Proposed Rule Change Amending the Codes of Arbitration Procedure to Establish Procedures for Arbitrators to Follow when Considering Requests for Expungement Relief, SEC, <http://www.sec.gov/rules/sro/finra/2008/34-58886.pdf> (last visited Nov. 1, 2013); C. Thomas Mason III, Letter to SEC, Mar. 31, 2003, <http://www.sec.gov/rules/sro/nasd2002168/ctmason033103.htm> (last visited Nov. 1, 2013); C. Thomas Mason III, *CRD Expungement: Laws, Proposed NASD Rules and Lawyer Ethics*, 9 PIABA B.J. 77 (2002).

10. See FINRA MANUAL, RULE 2080(b) (2013), Obtaining an Order of Expungement of Customer Dispute Information from the Central Registration Depository (CRD) System; Notice to Arbitrators and Parties on Expanded Expungement Guidance, <http://www.finra.org/ArbitrationAndMediation/Arbitration/>

However, controversy surrounds the expungement process for CRD records of cases that settle for money before any arbitration hearing is held.<sup>11</sup> Such situations present a danger that expungements are “purchased” in cases where a complaining investor is paid a substantial sum of money in exchange for a “Stipulated Award” of expungement or for an agreement to not oppose the registered representative’s expungement request.<sup>12</sup> Such paid agreements increase the likelihood

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SpecialProcedures/Expungement/index.htm (“In making these determinations, arbitrators should consider the importance of maintaining the integrity of the information in the CRD system.”).

11. See Susan Antilla, *A Rise in Requests From Brokers to Wipe the Slate Clean*, N.Y. TIMES, June 10, 2013, [http://dealbook.nytimes.com/2013/06/10/a-rise-in-requests-from-brokers-to-wipe-the-slate-clean/?\\_r=0](http://dealbook.nytimes.com/2013/06/10/a-rise-in-requests-from-brokers-to-wipe-the-slate-clean/?_r=0); Suzanne Barlyn, *Wall Street Watchdog to Review Tactic for Cleaning Broker Records*, REUTERS, Aug. 2, 2013, <http://www.reuters.com/article/2013/08/02/us-finra-expungement-idUSBRE9710WA20130802>; Dan Jamieson, *Record-Cleaning Rules for Registered Reps to Get FINRA Tweak*, INVESTMENT NEWS (Aug. 6, 2013, 3:40 PM), <http://www.investmentnews.com/article/20130806/FREE/130809952>; Dan Jamieson, *New FINRA Rules Could Help Brokers Clear Records in Certain Cases*, INVESTMENT NEWS (Aug. 8, 2013, 4:57 PM), <http://www.investmentnews.com/article/20130808/FREE/130809919>; Jean Eaglesham & Rob Barry, *Stockbroker Requests to Scrub Complaints Are Often Granted*, WALL ST. J., Oct. 16, 2013, at C1; see also Lynnley Browning, *Site That Tracks Brokers Questioned on Erased Cases*, N.Y. TIMES, Dec. 14, 2007, [http://www.nytimes.com/2007/12/14/business/14regulate.html?\\_r=1&ref=business&oref=slogin](http://www.nytimes.com/2007/12/14/business/14regulate.html?_r=1&ref=business&oref=slogin); Karen Donovan, *The Expungement Campaign*, REGISTERED REP MAG., Nov. 1, 2007, <http://wealthmanagement.com/practice-management/expungement-crusade>; Howard R. Elisofon & Grant R. Cornehl, *The Road to Expungement Grows Longer*, SEC. ARB. COMMENTATOR, Sept. 2010, at 1.

12. See Antilla, *supra* note 12 (“Critics of FINRA policies also say many brokers are simply purchasing a clean record by offering substantial money in return for the customer’s agreement not to oppose an expungement request.”); see also Barlyn, *supra* note 12.

After the research in this Article was first presented on October 14, 2013, FINRA emailed a Notice to its arbitrators expressing this concern:

Asking Whether Settlements Are Conditioned on Agreements Not to Oppose Expungement

Arbitrators should inquire and fully consider whether a party conditioned a settlement of the arbitration upon agreement not to oppose the request for expungement in cases in which the investor does not participate in the expungement hearing or the requesting party states that an investor has indicated that he or she will not oppose the expungement request.

that this highly valuable customer complaint information is erased from the public record.<sup>13</sup>

Since 1999, FINRA has tried to define standards and impose procedural safeguards to prevent unwarranted or inappropriate expungements at the arbitration level.<sup>14</sup> In addition, FINRA requires registered representatives seeking expungement to obtain a court's confirmation of any expungement award and to give FINRA notice of that judicial proceeding in order to give FINRA (or a state securities regulator) the opportunity to oppose it.<sup>15</sup>

This Article demonstrates that the safeguards and procedures that FINRA created do not work as intended. Expungements, which FINRA repeatedly describes in its Notices to Members ("Notices" or "NTMs")<sup>16</sup> and rule filings with the U.S. Securities and Exchange Commission ("SEC")<sup>17</sup> as an "extraordinary remedy,"<sup>18</sup> are being granted in settled cases at a rate of 93.7%.<sup>19</sup> Expungement applications are made in over one-fifth of all settled cases.<sup>20</sup> This Article, with a focus on the ex parte nature of post-settlement expungement proceedings, analyzes the reasons for the discrepancy between these expungement trends and the stated purpose of expungement according to FINRA and the SEC.<sup>21</sup> This Article also shows that the supposed safeguards of notice to regulators and judicial confirmation of expungement awards have failed to serve their purposes.<sup>22</sup>

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*Notice to Arbitrators and Parties on Expanded Expungement Guidance*, FINRA, <http://www.finra.org/arbitrationandmediation/arbitration/specialprocedures/expungement/> (last visited Nov. 1, 2013).

13. See NASD, NTM 01-65, *supra* note 3.

14. See generally *infra* Parts I.B & II.A.

15. *Id.*

16. "FINRA publishes Notices to provide firms with timely information on a variety of issues." *2013 Notices*, FINRA, <http://www.finra.org/Industry/Regulation/Notices/2013/index.htm>.

17. The SEC regulates the securities industry and FINRA. See *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, SEC, <http://www.sec.gov/about/whatwedo.shtml#laws>, (last visited Nov. 1, 2013); *What We Do*, FINRA, <http://www.finra.org/AboutFINRA/WhatWeDo/> (last visited Nov. 1, 2013).

18. See sources cited *infra* note 123.

19. See *infra* Part IV.

20. *Id.*

21. See *infra* Parts IV-V.

22. See *infra* Part II.B.



Part I introduces the CRD system and the background of the expungement controversy.<sup>23</sup> It then traces FINRA's attempts to address these expungement issues, from its 1999 moratorium on arbitrator-initiated expungements of customer complaints through a series of FINRA Notices that led to FINRA's adoption in 2003 of Rule 2080,<sup>24</sup> which empowers arbitrators to grant expungements.<sup>25</sup> Although that Rule was supposed to limit the circumstances in which arbitrators could grant expungement,<sup>26</sup> it appears to do little more than enable a rubber-stamping process.<sup>27</sup>

By late 2007, it was clear that the definitions and safeguards that FINRA created in 2003 were not working.<sup>28</sup> Part II details and analyzes a series of cases that show that some state regulators were concerned about many arbitrators rubber-stamping expungement requests.<sup>29</sup> Those decisions also show that once arbitrators enter an award of expungement, the regulators had little, if any, power to stop the expungement of CRD information.<sup>30</sup>

As a result, in 2008, FINRA adopted Rule 12805, also purportedly designed to limit the expungements agreed upon in settlement agreements and to preserve the regulatory and informational value of CRD.<sup>31</sup> Part III examines this Rule, which requires arbitrators to hold hearings regarding the possibility of expungement<sup>32</sup> and to consider the settlement amount.<sup>33</sup> To grant expungement, the arbitrator must find

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23. See *infra* Part I.

24. The Rule was titled NASD 2130 when adopted but was renumbered in 2009 as FINRA Rule 2080. See FINRA, REGULATORY NOTICE 09-33, SEC APPROVAL AND EFFECTIVE DATE FOR NEW CONSOLIDATED FINRA RULES (2009), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p118967.pdf>.

25. See *infra* Part I.B.

26. See NASD, NTM 04-16, *infra* note 119; see also discussion *infra* Part I.B.

27. See *infra* Part IV.

28. See *infra* Part II.

29. See *infra* Part II.

30. See *infra* Part II.B.

31. See *infra* Part III.A.

32. See FINRA MANUAL, RULE 12805(a) (2013), Expungement of Customer Dispute Information under Rule 2080, available at [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=7229](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=7229) (last visited June 16, 2013) [hereinafter FINRA MANUAL, RULE 12805(a)].

33. See FINRA MANUAL, RULE 12805(b) (2013), Expungement of Customer Dispute Information under Rule 2080, available at <http://finra.complinet.com/en/>

that the complaint was erroneous or false or that the representative was not involved in a sales practice violation,<sup>34</sup> and the arbitrator must provide a “brief written explanation” for such finding.<sup>35</sup> Part III also addresses the 2009 change that increased the incidence of reporting customer complaints.

In order to learn whether the 2008 changes have made any difference, Part IV of this Article studies and analyzes all of the post-settlement arbitration awards rendered in the first half of 2013.<sup>36</sup> The study shows that even with the Rules and their supposed safeguards, arbitrators still grant expungement in virtually every settled case in which expungement is requested.<sup>37</sup> No one opposed the expungement application in all but three of the 205 cases studied, and each of those three cases resulted in a denial of expungement.<sup>38</sup> In all of the other cases, the arbitrators heard only the registered representative protest innocence, and they saw only the evidence that the representative wanted the arbitrators to see.<sup>39</sup> Almost two-thirds of the hearings

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display/display\_main.html?rbid=2403&element\_id=7229 (last visited June 16, 2013) [hereinafter FINRA MANUAL, RULE 12805(b)].

34. According to FINRA, the term “involved” (within the meaning of “involved in a sales practice violation”) “includes both doing an act and failing reasonably to supervise another in doing an act.” FINRA FAQ “Form U4 and U5 Interpretive Questions and Answers,” at 7, revised Jan. 2, 2013, available at <http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p119944.pdf>. The term “sales practice violation” is defined to include “any conduct directed at or involving a customer which would constitute a violation of any rules for which a person could be disciplined by any self-regulatory organization; any provision of the Securities Exchange Act of 1934; or any state statute prohibiting fraudulent conduct in connection with the offer, sale, or purchase of a security or in connection with the rendering of investment advice.” *Id.* at 9; see also Form U4 Uniform Application for Securities Industry Registration or Transfer, revised May 2009, at 11, available at <http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015111.pdf>.

35. See FINRA MANUAL, RULE 12805(c) (2013), Expungement of Customer Dispute Information Under Rule 2080, available at [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=7229](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=7229) (last visited June 16, 2013) [hereinafter FINRA MANUAL, RULE 12805(c)].

36. See *infra* Part IV.

37. See SETH LIPNER, ANALYSIS OF EXPUNGEMENT AWARDS IN SETTLED FINRA CUSTOMER ARBITRATIONS JANUARY 1, 2013 - JUNE 30, 2013 (2013), available at <http://aux.zicklin.baruch.cuny.edu/lipner/expungement.pdf> [hereinafter LIPNER, ANALYSIS OF EXPUNGEMENT AWARDS FOR FIRST HALF OF 2013].

38. See *infra* note 233 and accompanying text; *infra* Part IV and accompanying notes.

39. *Id.*

resulting in expungement were conducted by telephone.<sup>40</sup> The study also shows that only twelve of these 205 telephone “hearings” took more than three and a half hours.<sup>41</sup>

Finally, Part V.A analyzes the problems associated with the current expungement process, demonstrating how and why the system has failed to achieve its goals. Part V.B then proposes an alternative system that, if adopted, would provide for appropriate notice and regulatory review of expungement applications, as well as end the ex parte arbitration hearings that ineffectively safeguard the CRD system.

## I. CRD BASICS AND THE EXPUNGEMENT CONTROVERSY

### A. CRD BASICS

Securities broker-dealers and their sales representatives are subject to a multitude of regulations at both the federal and state levels.<sup>42</sup> The federal responsibility is delegated by the SEC to FINRA, a self-regulatory organization.<sup>43</sup> In its role as a regulator, FINRA sets licensing requirements, administers licensing examinations, establishes and enforces regulations concerning the conduct of licensed entities and persons, and maintains an Enforcement Division to discipline violators.<sup>44</sup>

State regulatory jurisdiction overlaps that of FINRA. Each state has its own licensing requirements, investigative and enforcement

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40. *Id.*

41. *Id.*; see also *Wexco Indus. v. UBS Fin. Servs., Inc.*, No. 11-01063, 2013 WL 653343 (FINRA Feb. 11, 2013); *infra* note 283 (regarding *Barker* and the expungement of twenty-two brokers’ CRD records after a telephonic hearing of three and a half hours).

42. Section 15(a)(1) of the Securities Exchange Act of 1934 (the “Exchange Act”) requires brokers and dealers to register with the SEC. See 15 U.S.C. § 78o(a)(1) (2012). Although many state securities laws do not cover broker-dealer regulation in depth, most states at the minimum require state registration or notification of federal registration as a broker-dealer. See THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 8.1 (2013). Additionally, state securities law, generally prohibit fraud in connection with securities transactions. *Id.*

43. See Onnig H. Dombalagian, *Demythologizing the Stock Exchange: Reconciling Self-Regulation and the National Market System*, 39 U. RICH. L. REV. 1069, 1075–76 (2005).

44. See *About the Financial Industry Regulatory Authority*, FINRA, <http://www.finra.org/AboutFINRA/> (last visited Jan. 25, 2013).

divisions, and adjudicatory mechanisms.<sup>45</sup> The state regulators coordinate their policies and activities through the North American Securities Administrators Association (“NASAA”).<sup>46</sup>

In 1981, FINRA, then known as the National Association of Securities Dealers, Inc. (“NASD”),<sup>47</sup> together with the states, created the CRD electronic database.<sup>48</sup> CRD contains a host of information about both brokerage firms (“firms”) and their registered representatives (“brokers”).<sup>49</sup> Each firm and broker has a unique identifier (a “CRD number”), and information concerning each is catalogued separately.<sup>50</sup> While FINRA and NASAA share ownership of CRD and

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45. See generally Joseph C. Long, 12A Blue Sky Law §1:41 (2010).

46. See *Our Role*, N. AM. SEC. ADMIN. ASS'N, available at [http://www.nasaa.org/about-us/our-role/](http://www.nasaa.org/about-us/our-role/http://www.nasaa.org/about-us/our-role/) (last visited Mar. 31, 2013).

47. FINRA combined the National Association of Securities Dealers, Inc. (the “NASD”) and the member regulatory functions of NYSE Group, Inc. (“NYSE”). See Roberta S. Karmel, *Should Securities Industry Self-Regulatory Organizations Be Considered Government Agencies?*, 14 STAN. J.L. BUS. & FIN. 151, 151–52 (2008).

48. See *CRD & IARD*, N. AM. SEC. ADMIN. ASS'N, available at <http://www.nasaa.org/industry-resources/investment-advisers/crd-iard/> (last visited Jan. 25, 2013). FINRA is the entity that currently operates the Web CRD system. See *Central Registration Depository (CRD)*, FINRA, available at <http://www.finra.org/Industry/Compliance/Registration/CRD/index.htm> (last visited Jan. 26, 2013).

49. The CRD system contains the registration records of more than 6,800 registered broker-dealers. The system also contains more than 660,000 active registered individuals' qualification (e.g. licenses and certifications), employment, and disclosure histories. See *Central Registration Depository (CRD)*, FINRA, <http://www.finra.org/Industry/Compliance/Registration/CRD/index.htm> (last visited Jan. 26, 2013).

50. A CRD number is a unique number assigned to an individual or firm as part of the financial services industry registration process. See *FINRA BrokerCheck – Search*, FINRA, <http://brokercheck.finra.org/Search/Search.aspx> (last visited June 16, 2013). Much of information for the CRD system is submitted by registered broker-dealers as part of the firms' reporting function. There are six types of Uniform Registration Forms used to file information with the Web CRD system. The relevant forms for the purposes of this Article are: (1) Form U4 and Form U5, (2) Form BD and Form BDW, and (3) Form U6. Broker-dealers use the U4 and U5 for the registration and termination of associated persons with SROs and jurisdictions. Broker-dealer firms use the Forms BD and BDW to register or terminate registration with the SEC, an SRO, and jurisdictions. Finally, SROs, regulators, and jurisdictions use the Form U6 to report disciplinary actions against broker-dealer firms and associated persons and to report arbitration awards. See *Current Uniform Registration Forms for Electronic Filing in Web CRD*, FINRA, <http://www.finra.org/Industry/Compliance/Registration/CRD/FilingGuidance/p005235> (last visited Jan. 25, 2013).

“BrokerCheck,” FINRA administers both databases.<sup>51</sup> However, both sets of regulators, along with the public, have a clear interest in the integrity of CRD information.<sup>52</sup>

The availability of CRD allows many individuals and organizations to access the information. FINRA, state regulators, and the SEC can access and use the information to fulfill their regulatory functions.<sup>53</sup> Prospective employers of brokers can view and use the information as part of their pre-hiring due diligence.<sup>54</sup> Lastly, investors can access a subset of CRD information about brokers through BrokerCheck, FINRA’s searchable online database.<sup>55</sup>

The record of customer complaints on a broker’s CRD is called “customer dispute information.”<sup>56</sup> Customer dispute information includes: (a) written complaints, (b) arbitrations that name the broker as a party, (c) litigation that names the broker as a party, and (d) arbitration awards and civil judgments.<sup>57</sup> In addition, since 2009, arbitrations and litigations in which the broker is not named as a party must be reported on CRD if the pleading alleges that the broker was involved in a sales practice violation.<sup>58</sup>

51. See *Exam FAQs*, N. AM. SEC. ADM’RS ASSOC., <http://www.nasaa.org/industry-resources/exams/exam-faqs/> (last visited Mar. 31, 2013) (noting that FINRA maintains the CRD).

52. See *infra* Part II.

53. See NASD, NTM 01-65, *supra* note 3, at 564.

54. See *id.* at 567.

55. The NASD renamed the “Public Disclosure Program” as “BrokerCheck” in 2003. See NASD, NOTICE TO MEMBERS 03-76: NASD SEEKS COMMENT ON ENHANCED ACCESS TO NASD BROKERCHECK (FORMERLY KNOWN AS NASD’S PUBLIC DISCLOSURE PROGRAM) (2003), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p003055.pdf>. Public investors do not have access to the CRD system, but the CRD’s information is available to investors via BrokerCheck.

56. See *supra* note 24; see also NASD, NOTICE TO MEMBERS 04-16: NASD ADOPTS RULE 2130 REGARDING EXPUNGEMENT OF CUSTOMER DISPUTE INFORMATION FROM THE CENTRAL REGISTRATION DEPOSITORY (2004), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p003235.pdf> [hereinafter NASD, NTM 04-16].

57. See FINRA Rule 2080 (Formerly NASD Rule 2130) Frequently Asked Questions, FINRA <http://www.finra.org/industry/compliance/registration/crd/filingguidance/p005224> (last updated Aug. 17, 2009).

58. See *Expungement*, FINRA, <http://www.finra.org/arbitrationandmediation/arbitration/specialprocedures/expungement/> (last visited June 16, 2013). Brokerage firms must submit a disclosure report about a broker even if the broker is not a named party to the arbitration or lawsuit. See *id.* A report is required merely when a broker is

The availability and value of this information conflicts with the interests of many in the brokerage industry. Brokers often argue that even a single publicly available record of a complaint can damage their business prospects.<sup>59</sup> Brokers are particularly concerned about information of un-adjudicated complaints on their CRD records, but FINRA continues to include that information in CRD and the publicly available BrokerCheck.<sup>60</sup> As a result, brokers want a method for seeking the expungement of customer dispute information from CRD.<sup>61</sup> However, FINRA, the state regulators, and the investing public have an interest in assuring that CRD information is complete and fighting to make expungement harder to obtain.<sup>62</sup> The stakes are high: information expunged from the CRD disappears from the view of all, including regulators, potential employers, and investors.<sup>63</sup>

FINRA's solution to these competing interests is to use FINRA's arbitration process to adjudicate expungement requests.<sup>64</sup> From 1981 to

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the "subject of" sales practice violation allegations in arbitration claims or civil lawsuits. *See id.*

59. *See Jamieson, supra* note 5. The 2009 change in reporting is discussed in Part III.B of this Article. *See infra* Part III.B.

60. *See supra* notes 5, 8 and accompanying text.

61. *See* NASD, NOTICE TO MEMBERS 99-09: NASD REGULATION IMPOSES MORATORIUM ON ARBITRATOR-ORDERED EXPUNGEMENTS OF INFORMATION FROM THE CENTRAL REGISTRATION DEPOSITORY (1999), *available at* <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p004582.pdf> [hereinafter NASD, NTM 99-09] (announcing a moratorium on the expungement of certain information, unless confirmed by a court, only six years after the beginning of the NASD's Public Disclosure Program (CRD) based on the frequency of arbitrator awarded expungements); *see also* Letter from Kevin M. Carroll, Managing Dir. and Assoc. Gen. Counsel, SIFMA, to Marcia E. Asquith, Office of the Corporate Sec'y, FINRA (May 21, 2012), *available at* <http://www.finra.org/Industry/Regulation/Notices/2012/P125948> (last visited June 16, 2013).

62. While adopting Rule 2080 regarding expungement, the NASD outlined the need for balancing three competing interests: (1) the interests of regulators and states in retaining access to customer dispute information for the purpose of meeting regulatory requirements and investor protection needs; (2) the interests of the brokerage community; and (3) the interests of investors in having access to complete and accurate information about financial professional with whom they conduct, or may conduct, business. *See* NASD, NTM 04-16, *supra* note 56.

63. By seeking "expungement," a broker seeks to have a reference to allegations or to involvement in an arbitration entirely removed from his or her CRD System record. *See Expungement*, FINRA, <http://www.finra.org/arbitrationandmediation/arbitration/specialprocedures/expungement/> (last visited June 16, 2013).

64. The principal function of FINRA's arbitration division is to administer and conduct arbitrations of disputes between customers and securities industry members,

1999, FINRA's policy was to erase customer dispute information from CRD if there were either a judgment or an arbitration award directing expungement.<sup>65</sup> There were no standards in place, no requirements that arbitrators had to follow before ordering expungement, and no regulatory or judicial review of expungement orders from arbitrators.<sup>66</sup>

#### B. THE EXPUNGEMENT MORATORIUM AND FINRA'S ADOPTION OF RULE 2080

In 1999, FINRA imposed a moratorium on arbitrator awards of expungement.<sup>67</sup> The expungement moratorium was a temporary means to resolve a clash that began in August 1998 between FINRA and state regulators regarding expungement awards.<sup>68</sup> Florida's Securities Commissioner wrote a letter to FINRA questioning the legality of arbitrator-directed expungements.<sup>69</sup> In January 1999, NASAA supported the Florida regulator and informed FINRA that, under the laws of certain states, information filed with the CRD system is a "state record," thereby subjecting CRD to all of the regulations and protocols that apply to state records, including provisions on expungement.<sup>70</sup> NASAA also asked FINRA to cease honoring arbitrator-directed expungements, opining that the laws of some states do not recognize the

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between securities industry members (i.e., firms), and between firms and their employees, including brokers. Since the 1987 U.S. Supreme Court decision in *Shearson v. McMahon* that held agreements to arbitrate broker-customer disputes as binding, nearly all disputes between brokerage firms and their customers have been resolved in arbitration. *See Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220 (1987) (holding that arbitration is a just and efficient method of resolving securities claims under the Exchange Act); *see also About the Financial Industry Regulatory Authority*, FINRA, <http://www.finra.org/AboutFINRA/> (last visited Jan. 25, 2013).

65. *See* NASD, NTM 01-65, *supra* note 3.

66. *See id.*

67. *See* NASD, NTM 99-09, *supra* note 61.

68. *See* NASD, NOTICE TO MEMBERS 99-54: NASD REGULATION SEEKS COMMENT ON ISSUES RELATING TO ARBITRATOR ORDERED EXPUNGEMENTS OF INFORMATION FROM THE CENTRAL REGISTRATION DEPOSITORY (1999), at 351-54, *available at* <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p004-219.pdf> (last visited Jan. 25, 2013) [hereinafter NASD, NTM 99-54] (citing Advisory Legal Opinion issued by Robert A. Butterworth, Attorney Gen. of the State of Fla., AGO 98-54 (Aug. 28, 1998)) (regarding records obtained from the securities dealer association's central depository).

69. *See id.*

70. *See* NASD, NTM 99-09, *supra* note 61.

authority of an arbitrator to expunge state records.<sup>71</sup> The agreement between NASAA and FINRA that created the CRD system expressly authorizes FINRA to honor judicially directed expungements but was silent as to arbitrator-directed expungements.<sup>72</sup> In February 1999, FINRA acceded to NASAA's views and announced a moratorium on arbitrator-awarded expungement of customer dispute information.<sup>73</sup>

Then, in July 1999, FINRA issued NTM 99-54 in order to provide its views on expungements awarded by arbitrators and to seek comments on how to proceed,<sup>74</sup> acknowledging that it had never developed a clear policy on how its arbitrators should decide expungement applications.<sup>75</sup> Notice 99-54 explains several of FINRA's goals. First, FINRA believed that the expungement of information from the CRD system that is directed by an arbitrator and contained in an arbitration award should be afforded the same treatment as a court-ordered expungement.<sup>76</sup> Second, the implementation of that policy should "comply[] with any applicable state record-keeping laws and maintain[] the integrity of the CRD system" because CRD had "important investor protection implications."<sup>77</sup> Accordingly, the information in the system should be "complete and accurate," and customer dispute information "should not be expunged without good reason."<sup>78</sup>

NTM 99-54 also raised another important issue: whether "consent awards," e.g., awards that memorialize a settlement of the investor's complaint and contain an agreement to expunge CRD information should be treated differently from awards rendered after a contested proceeding.<sup>79</sup> The concern over consent awards (which FINRA will later call "Stipulated Awards")<sup>80</sup> was well founded, as arbitrators were issuing consent awards based exclusively on the parties' (joint)

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71. *Id.*

72. *Id.*

73. *Id.*

74. *See* NASD, NTM 99-54, *supra* note 68.

75. *Id.*

76. *Id.*

77. *See id.* at 352.

78. *Id.*

79. *Id.*

80. *See* NASD, NTM 01-65, *supra* note 3, at 567 (defining consent awards as "Stipulated Awards," which are of particular concern because of the lack of fact-finders or formal hearings inherent in the settlement process).



request.<sup>81</sup> Furthermore, significant amounts of money were paid to complainants in settlements that included an agreed expungement.<sup>82</sup>

The Notice describes FINRA's objective—"ensur[ing] that investor protection is not compromised" by paid-for expungements.<sup>83</sup> FINRA's approach to the problem was to set appropriately high standards so that expungements are not granted in questionable circumstances.<sup>84</sup> High standards "would enhance the integrity of the CRD system" while still providing a mechanism to remove misleading, inaccurate, or erroneous information from CRD.<sup>85</sup> FINRA offered examples of circumstances in which expungement would be warranted, such as a customer complaint that was frivolous or groundless (i.e., the claim had no basis in fact) or brought for an improper purpose (i.e., to damage the reputation of the named person/firm).<sup>86</sup>

In 2001, FINRA issued another Notice about expungements, NTM 01-65.<sup>87</sup> The main purpose of Notice 01-65 was to vet FINRA's new ideas about how to balance a broker's reputational concerns against the regulatory and public interests identified in the 1999 Notices.<sup>88</sup> This Notice describes the comments submitted to FINRA after NTM 99-54 as "mixed."<sup>89</sup> Industry-affiliated commenters generally favored arbitrator-awarded expungements<sup>90</sup> while most non-industry opposed them.<sup>91</sup> In

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81. See NASD, NTM 99-54, *supra* note 68, at 352.

82. *Id.* FINRA offered several approaches to the problem of settled cases. One approach was to retain the complaint information on the CRD system but delete it from BrokerCheck. See *id.* at 353. Another approach was to maintain the information in both places but add a legend that the complaint had been ordered expunged by an arbitrator or a panel of arbitrators. *Id.* A third approach was to establish standards for arbitrator-ordered expungements resulting from consent awards. *Id.* A fourth approach, similar to the first, was to delete the information from CRD and Broker-Check after first sending a record to each state through an alternative medium, such as hard copy or microfilm. See *id.*

83. See NASD, NTM 99-54, *supra* note 68, at 353.

84. See *id.* at 352.

85. *Id.* at 353.

86. See *id.* at 354.

87. See NASD, NTM 01-65, *supra* note 3.

88. See *id.*

89. *Id.* at 565.

90. See *id.*; see also Letter from Stuart J. Kaswell, Senior Vice President and Gen. Counsel of Sec. Indus. Assoc., to Joan C. Conley, NASD Secretary (July 30, 1999), available at [www.sifma.org/workarea/downloadasset.aspx?id=1365](http://www.sifma.org/workarea/downloadasset.aspx?id=1365) (commenting that SIA believes there is no basis to change the pre-moratorium system).

91. See NASD, NTM 01-65, *supra* note 3, at 565.

NTM 01-65, FINRA, for the first time, cited the concern for damaged reputations as a factor in formulating expungement policy.<sup>92</sup> FINRA reiterated that it wanted to promote an arbitrator-expungement process.<sup>93</sup>

NTM 01-65 states that the creation of high standards must be part of the solution<sup>94</sup> because expungement is an “extraordinary” remedy.<sup>95</sup> The Notice explains that FINRA would permit expungement in any case where a fact-finder—an arbitration panel or court—had conducted an adversarial hearing and concluded that the case fell into one of the three enumerated categories: (1) “factual impossibility or ‘clear error’”; (2) a legally meritless claim; or (3) the CRD information “is determined to be defamatory.”<sup>96</sup> NTM 01-65 sought comments as to whether these three categories were the appropriate ones.<sup>97</sup>

The Notice then turns to the problem of Stipulated Awards, again characterizing expungement relief as extraordinary.<sup>98</sup> Just as in 1999, FINRA expressed concerns that a firm may pay a customer who filed a claim to settle on the condition that the customer agrees to the expungement of all of the information about the claim from the broker’s CRD.<sup>99</sup> FINRA stated its awareness of “allegations that firms have pressed customer/claimants into accepting expungement as a condition of settlement of arbitration proceedings.”<sup>100</sup> FINRA conceded that despite the fact that arbitrators are not required to sign awards with which they disagree, many arbitrators were executing Stipulated Awards without inquiry.<sup>101</sup> FINRA acknowledged that settling parties do not share the interests of regulators and the investing public about the accuracy and completeness of CRD.<sup>102</sup>

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92. *See id.*

93. *Id.* NASD Notice to Members 99-09 and NASD Notice to Members 99-54 made no express reference to reputational damage. *See generally* NASD, NTM 99-09, *supra* note 61; NASD, NTM 99-54, *supra* note 68, at 351–54.

94. *See* NASD, NTM 01-65, *supra* note 3, at 565.

95. *Id.*

96. FINRA offers cases where the person named in the complaint was “named in error” as example of cases that fall into this category. *Id.*

97. *Id.* FINRA stated that the fact that the party seeking expungement had prevailed was not itself conclusive, because expungement was extraordinary relief. *Id.* FINRA also said that expungement should never be granted when the award was adverse to the party seeking expungement of the issue. *Id.* at 566.

98. *See id.* at 563.

99. *See id.* at 567.

100. *See id.* at 570.

101. *See id.* at 567.

102. *See id.* at 565.

However, FINRA also stated that it did not want expungement issues to discourage settlements.<sup>103</sup> FINRA argued that it could strike an appropriate balance by limiting expungement in settled cases to cases of “factual impossibility” or “clear error.”<sup>104</sup> The Notice stated that FINRA was not proposing to include the other two bases (*viz.* “without legal merit” or “defamatory”) as grounds for expungement in settled cases for two reasons. First, “it is unlikely that [the investor’s] counsel would agree to such findings as part of a settlement,” and second, because the case was settled, no fact finder would be in a position to determine that the claim was “without legal merit” or was “defamatory.”<sup>105</sup>

FINRA also explained in NTM 01-65 that it would still require: (1) judicial confirmation of all arbitration awards granting expungement, and (2) that FINRA receive notice of all applications for judicial orders of expungement.<sup>106</sup> FINRA promised that it would review all such applications—to ensure that the cases meet the criteria described in the Notice—and advise the courts of its conclusion.<sup>107</sup> FINRA also promised to notify state regulators every time it received notice of an application for a judicial order of expungement so that “one or more states may . . . intervene in the . . . proceeding.”<sup>108</sup> The Notice said

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103. *Id.* at 565 (“NASD Regulation also has been concerned about crafting an approach that does not have an overly broad chilling effect on the settlement process . . .”).

104. *Id.* at 563. These categories, according to FINRA, were exemplified by situations where the person named in a complaint did not work at the firm at the time of the complaint. “[S]uch persons,” FINRA reasoned, “should be able to avail themselves of the settlement opportunity,” and then request expungement. *Id.* at 567.

105. *Id.*

106. *Id.* The requirement would include both applications to confirm awards of expungement and applications of settlements of cases outside of the arbitration process that are then submitted for court approval. *See id.*

107. *See id.* at 567.

108. *Id.* In NTM 01-65, FINRA should have known that it was wading into a deep thicket. *See id.*; NASD, NTM 99-09, *supra* note 61; NASD, NTM 99-54, *supra* note 68. The Notice contained a form, with boxes to check, indicating the commenter’s answer to specific questions. *See* NASD, NTM 01-65, *supra* note 3, at 571. FINRA received 579 responses to NTM 01-65. *See* NASD, PROPOSED RULE 2130 GOVERNING EXPUNGEMENT OF CUSTOMER DISPUTE INFORMATION FROM THE CENTRAL REGISTRATION DEPOSITORY (CRD SYSTEM) (2002), at 10, *attached to* Letter from Barbara Z. Sweeney, Senior Vice President and Corp. Secretary, NASD, to Katherine A. England, Assistant Dir., SEC. (Nov. 18, 2002), *available at* <http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p001015.pdf> (last visited Jan. 25, 2013) [hereinafter NASD, PROPOSED RULE 2130]. Of the

nothing about the standards that FINRA would apply in the promised review, nor did it say what FINRA would or could do in the event the review showed that the expungement was not justified.<sup>109</sup>

On November 19, 2002, FINRA proposed the new expungement Rule 2130.<sup>110</sup> The proposed Rule was similar to the approach described in NTM 01-65, but there was a very important difference when it came to settled cases. Under the proposed Rule, Stipulated Awards would be treated the same as awards following an adversarial hearing; there would be no difference between adjudicated cases and settled cases.<sup>111</sup> A case falling into any of the three broad, somewhat re-worked categories justified an arbitration award of expungement.<sup>112</sup>

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579 responses, 539 were responses on the check-the-boxes form. *See id.* at 10. The vast majority of these were sent from brokers (mostly from one firm), all indicating that expungements—whether after a hearing or as a result of settlement—should be unregulated and recognized without condition. *Id.* The forty written comments were predictably mixed—industry participants were opposed to any regulation, or were reluctantly amenable, so long as the bases were adjusted and expanded. *Id.* at 12–15. The investor advocates who wrote were mostly opposed to all arbitrator-directed expungements, indeed to any expungement. *See id.* The investor advocates questioned whether FINRA arbitrators could be relied upon to make appropriate findings and whether FINRA enforcement would truly serve the public interest at the confirmation stage. *See id.* They noted that arbitration award confirmation rarely involved meaningful judicial scrutiny, especially when the requested relief was unopposed. *See id.*

109. NASD, PROPOSED RULE 2130, *supra* note 108, at 1.

110. *See id.*

111. *See id.* at 4–5. *See generally* Order Granting Approval of NASD Proposed Rule Change Concerning the Expungement of Customer Dispute Information From the Central Registration Depository System, 68 Fed. Reg. 74667 (Dec. 24, 2003).

112. *See* NASD, PROPOSED RULE 2130, *supra* note 108, at 4–5. The three bases, however, were reworked from the 2001 Notice. The first—the “factually impossible/clear error” category—was changed to “without factual basis”; the second—“without legal merit”—was changed to “the complaint fails to state a claim upon which relief can be granted or is frivolous”; while the third category—that the information on the CRD system was “defamatory in nature”—was unchanged from the 2001 NTM. *Compare* NASD, NTM 01-65, *supra* note 3, with *Proposed Rule 2130 Governing Expungement of Customer Dispute Information From the Central Registration Depository (CRD System)*, FINRA (2002), <http://www.finra.org/Industry/Regulation/RuleFilings/2002/P001160>.

In September 2003, as the rule proposal proceeded toward SEC approval, FINRA offered an amendment that proposed yet more modifications to its enumeration of the three bases. *See* Letter from Shirley H. Weiss, Assoc. Gen. Counsel, NASD, to Jonathan G. Katz, Secretary, SEC (Sept. 11, 2003), *available at* <http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p00>

FINRA gave no explanation for why it expanded the available bases for waiving the requirement to name FINRA as a party in post-settlement awards. The concerns about purchased expungements had apparently disappeared from FINRA's view.<sup>113</sup> In the Rule filing, FINRA simply explained that its purpose was to validate arbitrator expungements.<sup>114</sup> Still, FINRA continued to tell the SEC that expungement should only be granted in circumstances that were extraordinary,<sup>115</sup> but by declining to limit expungement to the "clearly

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1019.pdf (last visited Jan. 25, 2013) (discussing Amendment No. 2 to Proposed NASD Rule 2130 Governing Expungement of Customer Dispute Information From the Central Registration Depository (CRD System)). The "without factual basis" category was changed back to "factually impossible or clearly erroneous." The "without legal merit" category, which had been changed to "fails to state a claim or is frivolous" in the 2002 rule proposal, was changed to "the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds"; and the "defamatory in nature" category was changed to "false." *Id.* at 4. The change to the first category is inconsequential because FINRA has repeatedly used the terms interchangeably. The change to the second category, where the broker was "not involved in the alleged sales practice violation," is well-dissected in *Page v. Brookstreet*, No. 09-00120, 2010 WL 3072237 (FINRA July 16, 2009), because the word "involved" is nowhere defined. The change to the third category—from "defamatory in nature" to "false"—appears to have turned post-settlement expungement proceedings into ex parte mini-trials about the truth or falsity of the complaint. *See Gilliam v. SagePoint Fin., Inc.*, No. 12-03717, 2013 WL 3963949 (FINRA July 19, 2013). The award in that case states that the arbitrator (who also was on the arbitration panel in *Page*) reviewed the FINRA award database to try to learn how other arbitrators have ruled on expungement issues and concluded that

most expungement decisions lump multiple grounds together without distinctions. Further, the reasons given frequently are not much more than conclusory reiterations of the findings and not careful discussions and analyses of the evidence. Many expungement decisions suggest that the panel did little more than have a mini ex parte trial on the merits, decided in favor of the respondent and granted expungement.

*Id.* at \*3; *see also In re Horn v. UBS Fin. Inc.*, No. 10-02215, 2011 WL 6596031, at \*3-4 (FINRA Dec. 7, 2012).

113. *See* NASD, PROPOSED RULE 2130, *supra* note 108.

114. *See id.*

115. *See id.*

erroneous or factually impossible” category, FINRA opened the door to a much easier expungement scheme.<sup>116</sup>

The SEC approved NASD Rule 2130 (now FINRA Rule 2080) on December 16, 2003.<sup>117</sup> In the approval order, the SEC determined that the Rule was “designed to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.”<sup>118</sup> The SEC wrote that “the potential involvement of [FINRA] at the court confirmation level will provide greater safeguards” of those interests.<sup>119</sup> As Part III.B of this Article demonstrates, both FINRA and the SEC were wrong in their belief that the court confirmation process provided “additional safeguards.”<sup>120</sup>

In March 2004, FINRA issued Notice to Members 04-16.<sup>121</sup> In that Notice, FINRA announced that the new expungement Rule would become effective on April 12, 2004.<sup>122</sup> The Notice, curiously, never describes expungement relief as “extraordinary.”<sup>123</sup> Instead, FINRA wrote:

If the parties settle the arbitration, they may jointly ask the arbitration panel for a stipulated award and request that the panel make affirmative findings and order expungement based on one or more of the standards in Rule 2130. The arbitrators would determine whether to grant expungement relief and, if so, state in the award the

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116. *See infra* Parts IV-V.

117. *Id.*

118. *See* NASD, PROPOSED RULE 2130, *supra* note 108, at 8.

119. *See* NASD, NOTICE TO MEMBERS 04-16, EXPUNGEMENT: MEMBERS’ USE OF AFFIDAVITS IN CONNECTION WITH STIPULATED AWARDS AND SETTLEMENTS TO OBTAIN EXPUNGEMENT OF CUSTOMER DISPUTE INFORMATION UNDER RULE 2130, *available at* <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p003235.pdf> [hereinafter NASD, NTM 04-16].

120. *See infra* Part III.B.

121. *See* NASD, NTM 04-16, *supra* note 119.

122. *See id.*

123. *See id.* The word appeared four times in NTM 01-65. *See* NASD, NTM 01-65, *supra* note 3. FINRA’s Rule Filing for Rule 2130 states clearly that FINRA and other regulators participating in the CRD system agree that expungement is extraordinary relief. *See* NASD, PROPOSED RULE 2130, *supra* note 108, at 8, 23. In support of its second proposed amendment to Rule Filing, FINRA wrote that it “recognize[d] that expungement of a CRD record under any condition is an extraordinary remedy and should only be used when the expunged information has no meaningful regulatory value.” *See* Letter from Shirley H. Weiss, Assoc. Gen. Counsel, NASD, to Jonathan G. Katz, Secretary, SEC, at 8 (Sept. 11, 2003), *available at* <http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p001019.pdf> (last visited Jan. 25, 2013).

basis on which the expungement relief was granted. The arbitrators may require the submission of documents or a brief evidentiary hearing to gather the information necessary to make such findings.<sup>124</sup>

After a five-year moratorium, expungement was back on the arbitrators' docket. However, the tenor of FINRA's message had changed. Granting expungement relief was cast in the Notice as a routine process in which the arbitrators' job was to "gather documents" that would enable them to make the needed findings.<sup>125</sup> The message in the Notice is that the arbitrators' role is to execute the request for expungement rather than conduct an independent, skeptical review.<sup>126</sup>

## II. EXPUNGEMENT AWARDS ARE CHALLENGED IN TWO STATES

### A. THE STATE OF MARYLAND INTERVENES IN THE *KARSNER* CASE

In 2006, Joseph Karsner IV, a broker in Maryland, received eighteen separate<sup>127</sup> arbitrator-approved expungements.<sup>128</sup> Each of these expungements had been preceded by a settlement. In one of the cases where Mr. Karsner sought confirmation of one of his expungement applications, the Securities Commissioner in Maryland objected.<sup>129</sup>

After receiving an award recommending expungement, Mr. Karsner petitioned the United States District Court for the District of Columbia for confirmation of the award.<sup>130</sup> He named as Respondents the investor and FINRA; neither Respondent appeared in the court to oppose the application.<sup>131</sup> The court was prepared to grant Mr.

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124. See NASD, NTM 04-16, *supra* note 119, at 214.

125. *Id.*

126. To this day, FINRA's template for arbitration awards of expungement makes reference to NTM 04-16 and no other FINRA document. See, e.g., arbitration awards cited *infra* note 235.

127. See PUB. INVESTORS ARBITRATION BAR ASS'N, STUDY OF STIPULATED OR SETTLED NASD CUSTOMER AWARDS ISSUED IN CALENDAR YEAR 2006 FOR WHICH STATEMENTS OF CLAIM WERE FILED ON, OR SUBSEQUENT TO, APRIL 12, 2004, at 14 (2007), available at <http://piaba.org/system/files/pdfs/September%2024%2C%202007%20including%20Expungement%20Study.pdf>.

128. See *Karsner v. Lothian*, 532 F.3d 876 (D.C. Cir. 2008).

129. See *Karsner v. Lothian*, No. 07-00334, 2007 WL 4459698 (D.D.C. Apr. 26, 2007).

130. See *id.*

131. See *id.*

Karsner's application when the Maryland Securities Commissioner filed a motion seeking permission to intervene.<sup>132</sup> Karsner opposed the Commissioner's motion,<sup>133</sup> and the district court denied the Commissioner's request to intervene.<sup>134</sup> The U.S. Court of Appeals reversed, however, holding that as a regulator, the State was interested in the outcome of the court proceeding and was thus entitled to intervene, and the case was remanded to the district court.<sup>135</sup>

The Court of Appeals' decision is important not just because it recognizes the regulatory interest of the states in the CRD system. In dicta, the court stated that the district court lacked the authority under the Federal Arbitration Act to grant confirmation because of the form of the award.<sup>136</sup> Written on a template FINRA provided to the arbitrators, the award stated that "[t]he Panel recommends the expungement of all reference to the above-captioned arbitration from Respondent Karsner's registration record maintained by the NASD Central Registration Depository ('CRD')." <sup>137</sup> The D.C. Circuit's opinion said:

Section nine of the FAA provides for the judicial confirmation of an arbitration award. But, the district court confirmed the arbitrators' recommendation of expungement. An expungement recommendation, however, is not an award and, accordingly, the district court is without section 9 authority to "confirm" it.<sup>138</sup>

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132. *See id.* The Maryland Securities Commissioner appealed the district court's denial of her motion to intervene as of right in an arbitration confirmation proceeding. *See id.* Karsner named Lothian and the NASD as parties to the confirmation proceedings. *See id.* The NASD notified NASAA, and NASAA notified Melanie Lubin, the Maryland Securities Commissioner. *See id.* Lubin objected. *See id.*

133. Neither Lothian nor FINRA appeared in the court proceedings.

134. *Karsner v. Lothian*, No. 07 cv334 (D.D.C. Apr. 9, 2007) (minute order).

135. *Karsner v. Lothian*, 532 F.3d 876 (D.C. Cir. 2008) (holding that the Commissioner's motion was timely, as required for intervention as of right, and that the District Court lacked the authority to "confirm" arbitrator's expungement recommendation).

136. *Id.* at 886.

137. *Id.*

138. *Id.* This theme that FINRA lacks the authority to empower courts to elevate a "recommendation" to a "direction" is inconsistent with the decision in *In re Kay v. Abrams*, 853 N.Y.S.2d 862 (N.Y. Sup. Ct. 2008), which held that courts lack the power to review expungement awards to ensure that the awards fall into one of the three categories. *See infra* Part III.B. Although both cases adopt the rationale of a limited judicial role, the *Kay* and *Karsner* courts reach opposite conclusions. *Compare Kay*, 853 N.Y.S.2d 862, with *Karsner*, 532 F.3d at 876. In *Kay*, the limited judicial role led to the court's ruling that the court was bound by arbitration law to confirm the award—



FINRA arbitration awards to this day, however, continue to use the same template and language as was used in *Karsner*—that the awards are “recommendations” of expungement and not directives.<sup>139</sup> However, no other court has yet adopted the D.C. Circuit’s restrictive view of the confirmability of FINRA expungement awards. FINRA has not changed its form award to change the word “recommends” to “directs,” probably because such language would violate the state laws that prevent arbitrators from altering state records—the laws that led to the original moratorium.<sup>140</sup> The decision of the influential D.C. Circuit, however, looms over FINRA’s entire method of allowing brokers to seek expungement and could reappear at any time.

The *Karsner* litigation ended a few months after the D.C. Circuit decision when the Maryland Securities Commissioner and Mr. Karsner entered into a settlement.<sup>141</sup> Mr. Karsner consented to findings that he made unsuitable recommendations to his unsophisticated clients, that he had falsified New Account Forms, and that he had engaged in improper “switching” of mutual funds in his clients’ accounts.<sup>142</sup> He also consented to Conclusions of Law that he violated the anti-fraud provision of Maryland’s securities laws and engaged in dishonest and unethical practices.<sup>143</sup> In the Consent Order, Mr. Karsner agreed to withdraw his application in *Karsner v. Lothian*, to seek no further expungements, to cooperate with the State of Maryland to vacate the expungements he already obtained, to pay a \$50,000, and not to renew his registration for ten years.<sup>144</sup>

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even if that court were troubled by a flawed process under which the arbitrators granted expungement. See *Kay*, 853 N.Y.S.2d at 862. The *Karsner* court, however, essentially declined to recognize or participate in the expungement process. See *Karsner*, 532 F.3d at 876.

139. See, e.g., any of the arbitration awards cited in this Article.

140. See *supra* Part I.B; see also NASD, NTM 99-09, *supra* note 61.

141. See Consent Order as to Joseph R. Karsner, IV and Joe Karsner & Associates, LLC, *In re Karsner*, No. 2002-0391 (Md. Sec. Comm’n Dec. 1, 2008), available at [www.oag.state.md.us/Securities/Actions/2008/Karsner\\_COFinal\\_12\\_08.pdf](http://www.oag.state.md.us/Securities/Actions/2008/Karsner_COFinal_12_08.pdf).

142. *Id.* at 4–5.

143. *Id.* at 5–6.

144. *Id.* at 6.

## B. NEW YORK—THE SEVEN CASES

At about the same time that Maryland was protesting the Karsner expungement, FINRA's expungement procedures also drew the attention of the newly elected New York Attorney General Andrew Cuomo.<sup>145</sup> The New York Attorney General made motions to intervene in seven cases where brokers were seeking to confirm expungement awards in New York state courts.<sup>146</sup> The Attorney General made a variety of arguments, including concerns that Rule 2080 findings in awards were mere recitals, that expungements were being bought, and that expungements violate public policy.<sup>147</sup>

As was the case in Maryland, the New York Attorney General's request to intervene in the seven cases in 2007 was based on that office's role as a securities regulator and its regulatory interest in preserving state records.<sup>148</sup> The request to intervene was granted in all but one of the cases.<sup>149</sup> The courts that granted intervention all found that New York State had a strong interest in maintaining the accuracy

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145. See Karen Donovan, *The Expungement Campaign*, REGISTERED REP MAG. (Nov. 1, 2007), <http://wealthmanagement.com/practice-management/expungement-crusade>; Elisofon & Cornehl, *supra* note 11, at 3.

146. The cases are: *In re BNY Inv. Ctr. Inc. v. Bacchus*, No. 109678/07, 2008 WL 6603842 (N.Y. Sup. Ct. June 13, 2008); *In re UBS Fin. Servs., Inc. v. Gibson*, 17 Misc.3d 1131(A) (N.Y. Sup. Ct. 2007); *In re Zaferiou v. Holgado*, No. 102996/07, 2008 WL 6677787 (N.Y. Sup. Ct. May 28, 2008); *In re Sage, Ruddy & Co. v. Salzberg*, No. 0001942/2007, 2007 WL 2174117 (N.Y. Sup. Ct. June 1, 2007); *In re Kay v. Abrams*, 853 N.Y.S.2d 862 (N.Y. Sup. Ct. 2008); *In re Johnson v. Summit Equities, Inc.*, 864 N.Y.S.2d 873 (N.Y. Sup. Ct. 2008); and *In re Walker v. Connelly*, 21 Misc.3d 1123(A) (N.Y. Sup. Ct. 2008).

147. See Elisofon & Cornehl, *supra* note 11, at 3. The Attorney General also argued in at least one of the cases that expungement should be denied because CRD records are state records that are subject to retention requirements and preclude arbitrator authority to order their expungement. See e.g., *BNY*, 2008 WL 6603842. That argument was rejected in *BNY* on the ground that, *inter alia*, the Attorney General had not identified any such requirements. See *id.* That same court also rejected the argument that the expungement was just a "recommendation," not an award that could be confirmed. *Id.*

148. See cases cited *supra* note 146.

149. In *Kay v. Abrams*, the court denied the motion to intervene on the ground that it was "moot" because the court determined that it lacked the power under the Federal Arbitration Act and New York arbitration law to conduct the kind of judicial review for which the Attorney General advocated. 853 N.Y.S.2d at 3–4.

and integrity of the CRD records for the protection of New York's investing public, just as had the D.C. Circuit in *Karsner v. Lothian*.<sup>150</sup>

The New York courts, however, all viewed their role in the expungement controversy as highly limited, rejecting the policy arguments made by the Attorney General.<sup>151</sup> Arbitration law proved to be insurmountable obstacle, and a prior decision of an intermediate appellate court in *Goldstein v. Preisler*<sup>152</sup> established the point. *Goldstein* was a 2005 case that predated the Attorney General's efforts and attention to the expungement issue.<sup>153</sup> The Appellate Division ruled that judicial review of such awards was limited to the usual grounds for vacatur of arbitration awards—fraud, arbitral misconduct, arbitrator partiality, irrationality, and manifest disregard of the law.<sup>154</sup> The Appellate Division's decision in *Goldstein* rejected any argument that the public's interest in preserving the CRD records was grounds to refuse confirmation.<sup>155</sup> Indeed, the Appellate Division stated that the lower court exceeded its judicial role by denying the broker's application to confirm the expungement award on policy grounds because that action constituted “an impermissible modification of the award that affected the substantive rights of the parties.”<sup>156</sup>

The Attorney General was confronted by the issues in *Goldstein* in each of the seven cases. In 2007, in two of the cases where the Attorney General intervened, the courts initially declined to confirm awards of

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150. See, e.g., *UBS*, 17 Misc. 3d 1131(A). That case attracted the attention of NASAA and the Securities Industry Financial Markets Association (“SIFMA”), both of which filed briefs as amicus. After granting the Attorney General's motion orally, the court entered a formal written decision. *Id.* at 1. In it, the court noted that “the Attorney General clearly has an interest which may be affected by the court's judgment, and which [sic] not been adequately represented by any other party, since respondent Gibson, the complainant in the arbitration proceeding, has failed to appear and has not opposed expungement in this case.” *Id.* at 4. That decision covered both the (separate) Kurasch (UBS) and Johnson (Summit Equities) applications, which had been consolidated by the court. *Id.* at 2. Intervention was also granted in other cases. See, e.g., cases cited *supra* note 146.

151. See *Elisofon & Cornehl*, *supra* note 11.

152. *In re Goldstein v. Preisler*, 805 N.Y.S.2d 647 (N.Y. App. Div. 2005).

153. See *id.*

154. *Id.*

155. See *id.*

156. *Goldstein*, 805 N.Y.S.2d at 649. The *Goldstein* court also stated that because the awards came in the form of stipulations, they were especially insulated, because stipulations can only be set-aside in cases of fraud or duress. *Id.*

expungement on the ground that the awards were not in accord with the requirements of FINRA Rule 2080.<sup>157</sup> These courts objected to confirmation because the awards in those cases only stated that the cases fell into the “false” category of Rule 2080.<sup>158</sup> The courts rejected the initial applications to confirm the awards because the arbitrators gave no explanation, and made no findings to support their decision that the claims were false.<sup>159</sup> These two cases were thus remanded to the arbitrators, who then modified the awards to provide brief explanations, and those awards were confirmed.<sup>160</sup>

*In re Johnson v. Summit Equities, Inc.* was the first of these New York court cases that preliminarily declined confirmation.<sup>161</sup> Justice Marcy Kahn (who consolidated *Johnson* with another similar cases assigned to her)<sup>162</sup> refused to confirm those two awards of expungement.<sup>163</sup> Justice Kahn rejected both because each award merely recited the Rule 2080 grounds in boilerplate fashion, without any arbitrator “findings,” elaboration, or explanation.<sup>164</sup> Rule 2080, she held, imposed “exacting standards for expungement,” and required that the arbitrators make “affirmative findings of specific facts” supporting their conclusion that the case fell into one of the three expungement categories.<sup>165</sup> The bald recitation by the arbitrators of the Rule 2080

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157. See *In re Johnson v. Summit Equities, Inc.*, 864 N.Y.S.2d 873 (N.Y. Sup. Ct. 2008); *In re Sage, Ruty & Co. v. Salzberg*, No. 0001942/2007, 2007 WL 2174117 (N.Y. Sup. Ct. June 1, 2007).

158. See *Johnson*, 864 N.Y.S.2d 873; see also *Sage, Ruty*, 2007 WL 2174117.

159. See cases cited *supra* note 158.

160. See *id.*

161. 864 N.Y.S.2d 873. The decision in *Johnson* covered both that case and *UBS (Kurasch) v. Gibson*. *Id.* at 882.

162. See *In re UBS Fin. Servs., Inc. v. Gibson*, 17 Misc. 3d 1131(A) (N.Y. Sup. Ct. 2007). The two cases had some differences: one was a stipulated award, and the other was an award of expungement after a full adversarial hearing. According to Justice Kahn, each contained the same defect. See *Johnson*, 864 N.Y.S.2d at 901. The arbitrators had made no findings to support their conclusion that expungement was warranted under FINRA Rule 2080(a). See *id.*

163. See *id.* at 901.

164. *Id.* at 890–95.

165. *Id.* at 898 (“Nothing in either award demonstrates the ‘finding’ of any facts specific to the case. The *Summit* award states neither the conduct in which petitioners were not engaged, nor any facts supporting a conclusion that petitioners were not the parties involved. In *UBS*, nothing indicates which aspects of the customer complaint were impossible or erroneous. Moreover, the language of the findings in each case are couched in the disjunctive as alternative conclusions, sounding more like general

grounds was, in Justice Kahn's view, insufficient, even where a full hearing was held and the investor's complaint was dismissed.<sup>166</sup>

Justice Kahn distinguished *Goldstein* because the award in that case predated Rule 2080<sup>167</sup> and thus was neither subject to nor reviewed for the issues associated with the "findings" requirement of Rule 2080.<sup>168</sup> In Justice Kahn's view, a higher degree of judicial review was appropriate following the effective date of Rule 2080 because Rule 2080 created "policy considerations and attendant roles and responsibilities . . . for the NASD, state regulators [and] reviewing courts" in expungement situations that were not at issue when *Goldstein* was decided.<sup>169</sup> The combined requirements in the Rule of "affirmative findings" and judicial confirmation convinced her that FINRA anticipated and

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denials characteristic of a pleading, rather than specific findings after a hearing or upon the parties' stipulated agreement in the particular case.").

166. *Id.* at 891–92 (finding that "only statements which contain evidentiary facts and demonstrate that the circumstances of Rule 2130(b)(1) exist in a particular case constitute factual findings that support the conclusions represented by the Rule's standards"). The decision further highlights that "the qualifier 'affirmative' was added to proposed Rule 2130 in order to meet concerns that members seeking expungement relief would arrange for 'findings' which consisted simply of *pro forma* recitals that 'matched [the wording of] one of the required standards.'" *Id.* at 892–99; *see also* Order Granting Approval of Proposed Rule Change and Amendment No. 1, Thereto, and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2, Thereto, Relating to Proposed NASD Rule 2130 Concerning the Expungement of Customer Dispute Information From the Central Registration Depository System, 68 Fed. Reg. 74,667, 74,670 (Dec. 24, 2003).

167. In *Kay v. Abrams*, the court explained the Attorney General's new-found interest in the subject of expungement:

At oral argument held on April 27, 2007, the Attorney General took the position that because of the claimed partial State ownership interest in CRD records, the arbitrator lacked the power to grant expungement as such an order would, in essence, be destroying State property. Consequently, it was contended that the court lacked the power to confirm such an award (tr. p. 35–37). When it was noted that no such claim had ever previously been asserted by the office of the Attorney General, it was stated that this was a new policy of Andrew Cuomo, the present holder of that office, which was decided upon in February of last year (tr. pp. 26–32).

853 N.Y.S.2d 862, 864–65 (N.Y. Sup. Ct. 2008) (footnotes omitted).

168. *See Johnson*, 864 N.Y.S.2d at 894.

169. *Id.* at 895.

intended greater judicial review, and she was prepared to conduct it.<sup>170</sup> However, Justice Kahn felt that such review could not occur in those two cases because the arbitrators had failed to make the required findings.<sup>171</sup> Justice Kahn remanded the matters to the arbitrators for further action in accordance with Rule 2080.<sup>172</sup> One of the two brokers pursued the matter further before the arbitrators; the other did not.<sup>173</sup> After the arbitrators entered a modified award with an explanation Justice Kahn sought, she confirmed the award.<sup>174</sup>

Similarly, in *Sage, Rutty & Co. v. Salzberg*, after granting the Attorney General permission to intervene, a New York court criticized the award for failing to make the affirmative findings required by Rule 2080.<sup>175</sup> The award showed that the arbitrators never held any evidentiary hearings to support their conclusion that the grounds of Rule 2080 were met.<sup>176</sup> The court held that *Goldstein* applied and that there was no room in the law for greater judicial review of expungement awards than exists for other types of arbitration awards.<sup>177</sup> However, the court also held that the arbitrators' mere recitation of grounds—without having ever held a hearing—was “irrational,”<sup>178</sup> and irrationality is a recognized basis for declining confirmation under New York arbitration law.<sup>179</sup> Thus, as did Justice Kahn in *Johnson*,<sup>180</sup> the judge in *Sage, Rutty*

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170. *Id.* at 890.

171. *Id.* at 895–96.

172. *Id.* at 901.

173. The arbitrators in the *UBS* portion of the case subsequently issued a modified award making “findings.” *In re Gibson v. UBS Fin. Servs., Inc.*, No. 06-00520, 2007 WL 562503 (FINRA June 15, 2009). FINRA’s award database does not show any record of further proceedings in *Johnson*, and there were no further court proceedings in that case.

174. *See* Order and Judgment, *In re UBS Fin. Servs., Inc. v. Gibson*, No. 103188/07 (N.Y. Sup. Ct. Nov. 17, 2009).

175. *In re Sage, Rutty & Co. v. Salzberg*, No. 0001942/2007, 2007 WL 2174117 (N.Y. Sup. Ct. June 1, 2007).

176. *Id.*

177. *Id.*

178. *Id.*

179. *Id.*; *see also In re Silverman v. Benmor Coats, Inc.*, 61 N.Y.2d 299, 308 (1984).

180. *In re Johnson v. Summit Equities, Inc.*, 864 N.Y.S.2d 873, 901 (Sup. Ct. 2008). *Cf. Walker v. Connelly*, 873 N.Y.S.2d 516 (Sup. Ct. 2008). In *Walker*, the court observed that even though the award in the case contained only a bare recitation of the Rule 2130 grounds and no “affirmative findings,” the arbitrators held a telephone conference call with counsel for the parties, and received an affidavit from the brokers seeking expungement and “Stipulated Factual Particulars” signed by counsel for both

remanded the case for further proceedings before the arbitrators.<sup>181</sup> Following that remand, a hearing before the arbitrators, and a new award with “findings,” the court confirmed the award.<sup>182</sup>

In the other four cases, the courts were either satisfied that the Rule’s requirements had been met, or ruled that it was not a court’s role to determine whether the Rule’s requirements had been met.<sup>183</sup> None of the New York courts held, as the *Karsner* court stated in dicta, that the award was not confirmable because it was only a “recommendation” and not a decision or directive.<sup>184</sup>

The other New York award review cases all resulted in easy confirmation. For example, in *Kay v. Abrams*,<sup>185</sup> Justice Edward Lehner

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the investor and the brokers. The Stipulation, the court wrote, was “essentially [a] recant[ation] of the allegations in his Statement of Claim,” and the broker’s affidavit was a total denial. *Walker*, 873 N.Y.S.2d 516, at \*6.

181. See *In re Sage*, Rutty & Co. v. Salzberg, No. 0001942/2007, 2007 WL 2174117 (N.Y. Sup. Ct. June 1, 2007).

182. See *Salzberg v. Sage Rutty*, No. 05-03906 (FINRA Oct. 24, 2007), *aff’d*, *Sage, Rutty*, 2007 WL 2174117. *Sage, Rutty* is unusual because it was the only case in which the investor appeared along with the Attorney General to oppose the expungement. See *id.* When the matter was remanded to the arbitrators, she appeared there as well. *Id.* In both proceedings, the investor was pro se. *Id.* The investor tried to explain her earlier consent to expungement by stating that she felt pressured by her lawyer to accept a settlement and that having agreed, she still believed that her allegations were true. *Id.* However, as both the court and the arbitrators observed, her agreement to expunge was made one full month after she had accepted the monetary settlement. After hearing her testimony, the arbitrators modified their prior award to add that finding. The arbitrators then wrote that her complaint was “clearly erroneous” and lacked merit, and recommended expungement. The court then confirmed the award. *BNY v. Bacchus* presented a similar settlement scenario. In that case, the court observed that agreement to expunge was entered into two years after the settlement and thus, could not have been “paid-for.” *In re BNY Inv. Ctr. Inc. v. Bacchus*, No. 109678/07, 2008 WL 6603842 (N.Y. Sup. Ct. June 13, 2008).

183. See *Bacchus*, 2008 WL 6603842; *In re Zaferiou v. Holgado*, No. 102996/07, 2008 WL 6677787 (N.Y. Sup. Ct. May 28, 2008); *In re Kay v. Abrams*, 853 N.Y.S.2d 862 (N.Y. Sup. Ct. 2008); *In re Walker v. Connelly*, 21 Misc. 3d 1123(A) (N.Y. Sup. Ct. 2008).

184. See discussion *supra* note 138; see, e.g., *Bacchus*, 2008 WL 6603842. Cf. *Dailey v. Legg Mason Wood Walker, Inc.*, No. 08-1577, 2009 WL 4782151 (W.D. Pa. Dec. 8, 2009) (confirming a FINRA award that recommends expungement and citing *Karsner v. Lothian* but not addressing at all the dicta about whether recommendations create confirmable awards).

185. See *Kay*, 853 N.Y.S.2d at 862.

adhered strictly to *Goldstein*.<sup>186</sup> He ruled that courts did not have any authority whatsoever to question the conclusions reached by arbitrators that Rule 2080's requirements had or had not been satisfied.<sup>187</sup> In his view, it was irrelevant whether the arbitrators conducted any hearings on expungement grounds or made any affirmative findings.<sup>188</sup> Federal and state arbitration law precluded all the types of judicial inquiry the Attorney General sought.<sup>189</sup> According to Justice Lehner, New York law was clear—neither the FINRA Rule<sup>190</sup> nor the Attorney General's arguments about protecting the public interest<sup>191</sup> changed the very limited review allowed of arbitration awards under state law and the Federal Arbitration Act.<sup>192</sup> FINRA could not pass rules that effectively

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186. *Id.* at 866 (“[S]ince [*Goldstein*] is on ‘all fours’ with the case at bar and there is no contrary First Department decision, the court feels bound by the determination therein.”).

187. *See id.*

188. *Id.* (“[T]raditionally, there is no mandate that an arbitrator give any reason for an award. Thus, for judicial confirmation, there is no requirement for the arbitrator to make any of the specific findings listed in the Rule.”).

189. *Id.* at 865. The court wrote:

While the Attorney General has declined to take a position as to whether the application for confirmation is governed by the Federal Arbitration Act (“FAA”) or the CPLR, it is clear that this matter involving the sale of securities is governed by the FAA. However, the parties agree that the rules on confirmation under the FAA and the CPLR are essentially similar.

*Id.* (internal citations omitted).

190. *Id.* Justice Lehner read Rule 2130's requirement of findings and grounds to be addressed solely to the portion of the Rule relating to FINRA's waiver of the requirement that it be named in the confirmation proceeding. According to the court, FINRA's amicus brief states that “its intent in adopting the Rule was to in no way affect the law with respect to the judicial confirmation of arbitration awards.” *Id.*

191. The judge in *Zaferiou v. Holgado* went further, stating that *Goldstein* “demonstrates that there is no public policy against expungement.” No. 102996/07, 2008 WL 6677787 (N.Y. Sup. Ct. May 28, 2008).

192. *See Kay*, 853 N.Y.S.2d at 862. Indeed, Justice Lehner seems to reject the notion that Rule 2130 empowered the Attorney General to oppose confirmation of arbitral findings on policy grounds. “[A] regulation of NASD, even if approved by the SEC, cannot modify the FAA which was adopted through an act of Congress.” *Id.* at 865; *see also Zaferiou*, 2008 WL 6677787; *In re BNY Inv. Ctr. Inc. v. Bacchus*, No. 109678/07, 2008 WL 6603842 (N.Y. Sup. Ct. June 13, 2008); *In re Walker v. Connelly*, 21 Misc. 3d 1123(A) (N.Y. Sup. Ct. 2008). To these courts, even the FINRA Rule 2130 requirement that the arbitrators make “findings” cannot be enforced by



amended the Federal Arbitration Act to elevate the level of review of FINRA's arbitration awards.<sup>193</sup>

At the end of his decision in *Kay*, however, Justice Lehner expressed discomfort with expunging information where "the arbitrator gave no explanation for his factual finding."<sup>194</sup> It did not matter in the case before him because the law was clear and because the grounds for vacatur were limited, but Justice Lehner offered a note of optimism.<sup>195</sup> He observed that improvement was coming because three days before oral argument in the case, FINRA announced that it was seeking a change in its Rules to require that arbitrators hold a recorded hearing on expungement.<sup>196</sup>

The New York Attorney General's efforts to oppose expungement were unsuccessful because his policy arguments were rejected.<sup>197</sup> He was left with a few quibbles about the form of the award, but that was all.<sup>198</sup> Two things, however, had become apparent: (1) FINRA had succeeded in empowering its arbitrators to grant expungement, and (2) the regulators' interest, though acknowledged by all of the courts, had largely been emasculated.

### III. FINRA AMENDS ITS RULES AGAIN IN 2008

#### A. FINRA ADDS RULE 12805

FINRA's response to the criticisms and the cases was to augment Rule 2080 by trying to add more safeguards to the process.<sup>199</sup> In its

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courts because arbitration law provides that arbitrators need not give reasons for their awards. *See cases cited supra.*

193. *Kay*, 853 N.Y.S.2d at 865. In this regard, Justice Lehner's decision foreshadowed the U.S. Supreme Court's decision in *Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008) (holding that the parties, in their arbitration agreements, cannot empower or authorize courts to conduct any greater level of review of arbitration awards than is provided in the FAA).

194. *Kay*, 853 N.Y.S.2d at 867.

195. *Id.*

196. *Id.*

197. *See discussion supra* note 147.

198. *See Elisofon & Cornehl*s, *supra* note 11.

199. *See Proposed Rule Change to Adopt Rule 12805 of the NASD Code of Arbitration Procedure for Customer Disputes and Rule 13805 of the NASD Code of Arbitration Procedure for Industry Disputes as FINRA Rules into a Consolidated Rulebook*, FINRA, <http://www.finra.org/Industry/Regulation/RuleFilings/>

March 2008 rule filing,<sup>200</sup> FINRA admitted that its system was not working as anticipated:

Sometimes, arbitrators will order expungement at the conclusion of an evidentiary hearing on the merits of the case. More often, however, arbitrators will order expungement at the request of a party to facilitate settlement of the dispute. For example, customers may receive monetary compensation as part of a settlement, the terms of which require the customer to consent to (or not oppose) the entry of a stipulated award containing an order of expungement. In such cases, FINRA expected that arbitrators would examine the amount paid to any party and any other terms and conditions of the settlement that might raise concerns about the associated person's behavior before awarding expungement. Contrary to this expectation, however, arbitrators often did not inquire into the terms of settlement agreements.<sup>201</sup>

Thus, proposed Rule 12805 requires arbitration panels that were asked to approve of an expungement following a settlement to “hold a recorded hearing session (by telephone or in person) regarding the appropriateness of expungement.”<sup>202</sup> The arbitrators would be required to review settlement documents and consider the amount of payments to the investor.<sup>203</sup> They would also have to indicate in the award which of the grounds in Rule 2080 “serve(s) as the basis for its expungement order” and to “provide a brief written explanation of the reason(s) for its finding that one or more Rule 2080 grounds for expungement applies to the facts of the case.”<sup>204</sup>

FINRA's filing for Rule 12805 states that the added requirement for arbitrators to hold a recorded hearing would assure that the arbitrators “perform the critical fact finding necessary before granting

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2008/P117539 (last visited Apr. 2, 2013).

200. Rule 12805 was proposed before the D.C. Circuit's decision in *Karsner v. Lothian*, wherein the court did all but declare that FINRA's expungement process—with awards that “recommend” expungement followed by court confirmation—was unworkable. See *supra* Part IV. Thus, the court did not address that issue, which continues to lurk to this day. See *id.*

201. Self-Regulatory Organizations: Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change Relating to Amendments to the Codes of Arbitration Procedure to Establish New Procedures for Arbitrators to Follow when Considering Requests for Expungement Relief, 73 Fed. Reg. 18,308, 18,309 (Apr. 3, 2008).

202. See FINRA MANUAL, RULE 12805(a), *supra* note 32.

203. See FINRA MANUAL, RULE 12805(b), *supra* note 33.

204. See FINRA MANUAL, RULE 12805(c), *supra* note 35.

expungement.”<sup>205</sup> FINRA acknowledged that the hearing it envisioned was likely to be *ex parte*.<sup>206</sup> First, FINRA stated that the customers could participate in such hearings.<sup>207</sup> However, it must have been apparent to FINRA that such participation rarely occurred.<sup>208</sup> Settling respondents often bargain for an agreement to not oppose expungement, and even when no such bargain is struck, investors who settle cases do not want to expend the time and money (including attorney’s fees) to appear in a case that had already settled.<sup>209</sup> Such investors were not showing up to contest expungements before 2008, so FINRA had no basis to believe that they would do so after 2008.<sup>210</sup>

FINRA’s second argument for perpetuating its system of arbitrator expungements was that its arbitrators are “trained to conduct *ex parte* proceedings.”<sup>211</sup> However, as will be seen,<sup>212</sup> no amount of arbitrator training can cure the inherent problem that non-adversarial, one-sided hearings inherently lack the adversarial mechanism needed for “fact finding.”<sup>213</sup>

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205. See Letter from Margo A. Hassan, to Nancy M. Morris, Secretary, SEC, at 2–3 (June 11, 2008), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p038692.pdf> [hereinafter Letter from Hassan to SEC].

206. *Id.* at 2 n.7.

207. *Id.*

208. *Id.*

209. See NASD, NTM 01-65, *supra* note 3. In addition, as FINRA observed in the quotation above from the Rule filing (cited in *supra* note 199), such parties could have agreed to not oppose expungement as a condition of settlement. Of all of the arbitrations studied for and cases cited in this Article, there was only one case of opposition—the investor in *Sage, Ruddy*. 2007 WL 2174117. Notably, that investor was *pro se* and thus, hardly had a fair fight because the respondent was represented by experienced arbitration counsel.

210. Letter from Karen Tyler, NASAA President and N.D. Sec. Comm’r, to Nancy M. Morris, Secretary, SEC, at 3 (Apr. 24, 2008), available at <http://www.sec.gov/comments/sr-finra-2008-010/finra2008010-7.pdf> (showing that FINRA and NASAA knew since 2008 that investors who settled had no incentive to appear at expungement hearings). Indeed, there is a disincentive because lawyers cost money.

211. Letter from Hassan to SEC, *supra* note 205, at 3; see also Notice of Filing of Proposed Rule Change Relating to Amendments to the Codes of Arbitration Procedure to Establish New Procedures for Arbitrators to Follow When Considering Requests for Expungement Relief, 73 Fed. Reg. 18,308.

212. See *infra* Part V.A.

213. In its response to the comments received by the SEC, FINRA wrote:

Despite these obvious flaws, the SEC approved the proposed Rule on October 30, 2008.<sup>214</sup> Henceforth, FINRA arbitrators were required to hold a “hearing”—formal or informal and in person or telephonic—before granting an expungement request.<sup>215</sup> The arbitrators would have to consider, at the least, the settlement amount<sup>216</sup> and would have to write something about the grounds for granting expungement.<sup>217</sup>

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To help prepare arbitrators for the new rule requirements, FINRA plans to (1) notify all arbitrators of the changes; (2) update its expungement training program to reflect the changes encompassed by the rule proposal and encourage all of its arbitrators to take the training; (3) publish an article in The Neutral Corner explaining the new rule; and (4) conduct a call-in workshop during which staff will discuss the rule changes and allow arbitrators and mediators to ask questions about the rules.

Letter from Hassan to SEC, *supra* note 205, at 3 n.8.

214. See Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Increase the Maximum Term for FLEX Options, 73 Fed. Reg. 66086 (Nov. 6, 2008).

215. See FINRA MANUAL, RULE 12805 (2013), Expungement of Customer Dispute Information Under Rule 2080, *available at* [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=7229](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=7229) (last visited June 16, 2013).

In order to grant expungement of customer dispute information under Rule 2080, the panel must:

(a) Hold a recorded hearing session (by telephone or in person) regarding the appropriateness of expungement. This paragraph will apply to cases administered under Rule 12800 even if a customer did not request a hearing on the merits.

(b) In cases involving settlements, review settlement documents and consider the amount of payments made to any party and any other terms and conditions of a settlement.

(c) Indicate in the arbitration award which of the Rule 2080 grounds for expungement serve(s) as the basis for its expungement order and provide a brief written explanation of the reason(s) for its finding that one or more Rule 2080 grounds for expungement applies to the facts of the case.

(d) Assess all forum fees for hearing sessions in which the sole topic is the determination of the appropriateness of expungement against the parties requesting expungement relief.

*Id.*

216. See FINRA MANUAL, RULE 12805(b), *supra* note 33 (requiring review settlement the amount of payments made to any party).

217. See FINRA MANUAL, RULE 12805(c), *supra* note 35 (requiring arbitrators to draft a brief written explanation of the reason(s) for its finding that one or more Rule

However, there would still be no prosecutor or complainant challenging the broker's version of events,<sup>218</sup> and only exculpatory evidence would be presented.<sup>219</sup> There would still be no advance notice to either FINRA's Enforcement Division or any state regulator and no opportunity for them to intervene or object before it was too late.<sup>220</sup> Expungement awards would still be framed as "recommendations" and not directions, leaving the *Karsner* decision lurking in the background.<sup>221</sup>

#### B. FINRA EXPANDS REPORTING OF CUSTOMER ARBITRATIONS

While the attention was focused on the expungement process, a then-existing hole in CRD and BrokerCheck was growing. Customer dispute information on CRD and BrokerCheck gets into CRD only when brokerage firms report.<sup>222</sup> Prior to 2009, the forms FINRA uses—the U4 and the U5<sup>223</sup>—did not require reporting in cases where a customer filed a lawsuit or arbitration against the firm without also naming the broker as a defendant or a respondent,<sup>224</sup> and investors' attorneys usually do not

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2080 grounds for expungement applies to the facts of the case). *See also Notice to Arbitrators and Parties on Expanded Expungement Guidance*, FINRA, <http://www.finra.org/arbitrationandmediation/arbitration/specialprocedures/expungement/> (last visited Nov. 1, 2013).

218. *See* FINRA MANUAL, RULE 12805 (2013); FINRA MANUAL, RULE 2080 (providing for neither notice to prosecutors or regulators nor a right to intervene).

219. *See infra* note 233 and accompanying text (regarding the fact that only three investors appeared to contest expungements in 205 expungement arbitrations).

220. *See* Elisofon & Cornhels, *supra* note 11 (stating that brokers seeking expungement should expect greater review by arbitrators and expressing concern that Rule 2080 does not invite greater judicial scrutiny of expungement awards).

221. *See supra* notes 136-40 and accompanying text.

222. *See* NASD, NTM 01-65, *supra* note 3.

223. *See* Question 14I on Form U4 and Question 7E on Form U5, *available at* <http://www.finra.org/Industry/Compliance/Registration/CRD/FilingGuidance/p005235> (last visited Jan. 25, 2013).

224. That is true even if, based on the body of the pleadings, the broker's conduct is the obvious subject of the complaint. *See* FINRA, REGULATORY NOTICE 09-23: SEC APPROVAL OF PROPOSED CHANGES TO FORMS U4 AND U5 AND FINRA RULE 8312, at 4-5 (2009), *available at* <http://www.finra.org/Industry/Regulation/Notices/2009/P118706> [hereinafter FINRA, REGULATORY NOTICE 09-23]; SIFMA, COMMENT LETTER, *supra* note 7, at 3.

name the broker as a respondent in arbitrations.<sup>225</sup> As a result, many arbitration filings that involved the conduct of “unnamed” brokers went unreported on CRD and BrokerCheck.<sup>226</sup>

In 2009, FINRA decided to plug the hole. Beginning May 18, 2009, arbitration filings (and lawsuits) would have to be reported as customer dispute information on a broker’s CRD so long as it is reasonably clear from the body of the pleadings that the broker was involved in an alleged sales practice violation.<sup>227</sup> This change greatly increased the incidence of reporting.<sup>228</sup> That increased incidence in reporting, in turn, created an increase in the volume of expungement requests, including the volume of requests in settled cases.<sup>229</sup> The incidence of expungement requests was about to explode.

#### IV. A STUDY OF THE EXPUNGEMENT AWARDS IN SETTLED CASES IN 2013

In the wake of all these changes, the Author conducted a study of arbitration awards in settled cases.<sup>230</sup> The period of time studied was the first six months of 2013. Using the FINRA database of arbitration awards, an electronic search was conducted for all arbitration awards in these periods that contain the word “expungement.” These awards were reviewed to identify only those which: (a) began as customer-initiated arbitrations or complaints, (b) were settled for money prior to the arbitrators holding any adversarial hearings, and (c) involved the broker (as a named or unnamed party) appearing before an arbitration panel requesting expungement.

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225. See Notice of Filing of Proposed Rule Change Relating to Proposed Changes to Forms U4 and U5, Exchange Act Release No. 59,616, 2009 WL 1212330 (Mar. 20, 2009); see also DAVID E. ROBBINS, *SECURITIES ARBITRATION PROCEDURE MANUAL* (5th ed., 2012). Principles of respondeat superior make the naming of brokers unnecessary. See *id.*

226. See FINRA, REGULATORY NOTICE 09-23, *supra* note 224.

227. See FINRA, Form U4, at 14(I)(c) and 14(I)(d), available at <http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015112.pdf> (last visited June 16, 2013) (requiring the filing party to disclose whether it has been involved in one or more sales practice violations that settled a “customer complaint/arbitration” prior to May 18, 2009 for an amount of \$10,000 or after May 18, 2009 for an amount of \$15,000 or more).

228. See *infra* notes 247-49 and accompanying text.

229. See *infra* note 247 and accompanying text.

230. See LIPNER, ANALYSIS OF EXPUNGEMENT AWARDS FOR FIRST HALF OF 2013, *supra* note 37.

Two hundred and five such awards were found. Only thirteen resulted in a denial of the request for expungement while 192 cases resulted in recommendations of expungement.<sup>231</sup> Thus, the expungement rate was 93.66%.

The investor objected to expungement in only three of the 205 cases.<sup>232</sup> In each of those cases, the request for expungement was denied.<sup>233</sup> There were no cases where an investor objected and expungement was granted.

In ten of the cases, the investor was not named as a party.<sup>234</sup> In those cases, the broker named only his firm as a party, a clever device

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231. Separate customer arbitrations were expunged through a single expungement proceeding in five of the cases studied. *See infra* note 240. Forty-eight of the cases involved erasure of records from CRD of either multiple complaints or multiple brokers/associated persons. See note 240 for examples of multiple-claimants cases. For multiple-broker cases, see, for example, *Dake v. Insphere*, 12-01045; *Merlin v. Briggs*, No. 12-009351; *Stolte v. UBS*, No. 11-04455; *Barker*, No. 12-01305. In the 205 cases studied, a total of 318 expungements were granted. Only thirteen expungement requests were denied. *See* LIPNER, ANALYSIS OF EXPUNGEMENT AWARDS FOR FIRST HALF OF 2013, *supra* note 37 (case numbers 21, 24, 25, 26, 42, 44, 67, 68, 93, 152, 153, 189, 199 in study). Thus, the ratio of total grants to requests is 96.1%.

232. *See infra* note 241.

233. *See In re Jessop v. Pruneyard Fin. Grp.*, No. 11-03992, 2013 WL 1857492 (FINRA Apr. 12, 2013); *In re Levi v. Capital Brokerage Corp.*, No. 11-0345, 2013 WL 772751 (FINRA Feb. 2, 2013); *In re Ahonen v. Golden Beneficial Sec.*, No. 11-2777, 2013 WL 3365258 (FINRA June 27, 2013). In *Horn v. UBS Fin. Inc.*, a case outside of the studied period, one arbitrator dissented from an award of expungement, writing that the broker did not show that the claims were “‘factually impossible’ but only that the claims lacked merit.” No. 10-02215, 2011 WL 6596031, at \*3–4 (FINRA Dec. 7, 2012) (Arbitrator Abigail Pessen, dissenting). The dissenting arbitrator stated that she did not believe that FINRA’s expungement rule applied to such a case. The fact that the claimant in that case opposed the expungement was a factor in that arbitrator’s decision. *Id.*

234. *See Vaughn v. Morgan Stanley Smith Barney LLC*, No. 13-00173, 2013 WL 3271289 (FINRA June 17, 2013); *Hyman v. Sec. Am., Inc.*, No. 12-02969, 2013 WL 2368505 (FINRA Aug. 5, 2013); *Headrick v. UBS Fin. Servs. Inc.*, No. 11-02059, 2013 WL 2368495 (FINRA May 17, 2013); *Miller v. Sec. Am., Inc.*, No. 11-03509, 2013 WL 1933872 (FINRA May 1, 2013); *Castillo v. UBS Fin. Servs. Inc.*, No. 12-03633, 2013 WL 1933873 (FINRA Aug. 3, 2013); *Lureen v. EPlanning Sec.*, No. 11-02066, 2013 WL 1088694 (FINRA Mar. 13, 2013); *Barker v. Sec. Am., Inc.*, No. 12-01305, 2013 WL 595840 (FINRA Feb. 26, 2013); *Glubiak v. Sec. Am., Inc.*, No. 12-01156, 2013 WL 395553 (FINRA Jan. 23, 2013); *Bott v. UBS Fin. Servs., Inc.*, No. 12-02699, 2013 WL 395553 (FINRA Jan. 25, 2013).

that deprived the investor of notice that the investor's complaint was subject to an expungement proceeding.<sup>235</sup>

The study shows that 150 of the hearings were done by telephone and that thirty-eight were in-person hearings.<sup>236</sup> Seventeen of the awards do not state whether the hearing was in person or on the phone.<sup>237</sup>

Of the awards, 193 resulted from a half-day hearing session (four hours or less, including breaks).<sup>238</sup> Ten cases involved two sessions, and only two took three or four sessions. No cases took more than four sessions. The incidence of post-settlement expungement awards is greater than 20% of all the settled cases.<sup>239</sup>

The 205 awards studied for this Article represent the expungement of customer complaints in 257 customer-initiated arbitrations.<sup>240</sup> FINRA reports that 2,730 arbitration cases were closed between January 1, 2013, and June 30, 2013.<sup>241</sup> FINRA also states that approximately 60% of arbitration filings involved customer claims (this statistic is hereinafter referred to as the "case-type ratio").<sup>242</sup> Assuming that the

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235. See LIPNER, ANALYSIS OF EXPUNGEMENT AWARDS FOR FIRST HALF OF 2013, *supra* note 37 (case numbers 30, 33, 53, 54, 116, 153, 161, 183, 185, 198).

236. See *id.*

237. See *id.* (case numbers 2, 7, 25, 32, 35, 49, 50, 60, 61, 114, 133, 135, 141, 145, 151, 152, 174).

238. FINRA measures sessions in half-day increments. See FINRA MANUAL, RULE 12000(n) (2013), Code Of Arbitration Procedure for Customer Disputes.

239. To obtain expungement, of course, the awards must first be confirmed in court pursuant to FINRA Rule 2080. See FINRA MANUAL, RULE 2080 (2013), Obtaining an Order of Expungement of Customer Dispute Information from the Central Registration Depository (CRD) System.

240. The awards in five cases involved the expungement of multiple arbitration filings. See *Pyle v. UBS Fin. Servs., Inc.*, No. 11-02351, 2013 WL 2898285 (FINRA June 6, 2013) (expunging three separate arbitration complaints expunged); *Hyman v. Sec. Am., Inc.*, No. 12-02969, 2013 WL 2368505 (FINRA Aug. 5, 2013) (expunging eight separate complaints); *Miller v. Sec. Am., Inc.*, No. 11-03509, 2013 WL 1933872 (FINRA May 1, 2013) (expunging eleven separate arbitration complaints); *Barker v. Sec. Am., Inc.*, No. 12-01305, 2013 WL 595840 (FINRA Feb. 26, 2013) (expunging thirty-one separate arbitration complaints); *Glubiak v. Sec. Am., Inc.*, No. 12-01156, 2013 WL 395553 (FINRA Jan. 23, 2013) (expunging four separate arbitration complaints). The 205 awards studied thus represent the closure of 257 arbitration cases.

241. See *Dispute Resolution Statistics*, FINRA, <http://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/AdditionalResources/Statistics/> (last visited Sept. 28, 2013) (reporting case statistics for the first six months of 2013).

242. This statistic is for cases filed in 2012. Report, Richard Berry, Senior Vice President and Director of Case Administration and Regional Office Services, FINRA to



case-type ratio for closed cases is approximately the same as the case-type ratio for filings,<sup>243</sup> there were 1,422 customer cases that closed between January 1 and June 30, 2013.<sup>244</sup> FINRA also reports that during that period, 246 customer cases went to hearing,<sup>245</sup> leading to the estimate that, between January 1 and June 30, 2013, 1,176 customer cases were either settled or withdrawn.<sup>246</sup>

As stated, there were 205 expungement hearings, representing 257 customer arbitrations. Therefore, approximately 21.9% (*viz.*, 257/1176) of the cases that settled in the first half of 2013 involved some post-settlement expungement proceedings. At the established rate of 93.7% identified in this study, about 20.4% of settlements in the first half of 2013 resulted in awards of expungement.

The study also shows that the incidence of expungement is rising. In the fourth quarter of 2011, for example, there were sixty-one post-settlement awards involving expungement, compared to eighty-nine in the fourth quarter of 2012.<sup>247</sup> The 40% increase in volume from 2011 to 2013 is probably attributable to the 2009 reporting change detailed in Part III.B of this Article.<sup>248</sup> However, some of the increase might also

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Expert Roundtable, Aug. 2, 2013 (Boston, Mass.) (copy of presentation on file with Author). It was 61% in the first six months of 2013. *See id.*

243. FINRA reports an average turnover time (i.e., filing to case closure) of 14.4 months. *See Dispute Resolution Statistics*, FINRA, <http://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/AdditionalResources/Statistics/> (last visited Sept. 28, 2013).

244. *See* LIPNER, ANALYSIS OF EXPUNGEMENT AWARDS FOR FIRST HALF OF 2013, *supra* note 37.

245. *Id.*

246. *Id.*

247. The data supporting these statistics are on file with the Author as FINRA does not keep historical statistics.

248. The rise in the number of expungements from 2011 to 2013 cannot by itself be attributed to the increase in cases filings following the 2008 market problems. Arbitration cases on average take fourteen months (sixteen to seventeen months for non-simplified cases) from filing to case-closure. *See Dispute Resolution Statistics*, FINRA, <http://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/AdditionalResources/Statistics/> (last visited Sept. 28, 2013). The greatest number of filings occurred in 2009 (over 7,000 cases customer and non-customer cases), followed by significant decreases in succeeding years. *Id.* Thus, by the end of 2011, most of those 2009 cases had worked their way through the system. Accordingly, the increase in expungement applications from the fourth quarter to 2011 through the fourth quarter of 2012 to the first half of 2013 cannot be attributed to the 2009 increase in filings. By

be due to increased broker awareness of the impact of BrokerCheck or the apparent ease of obtaining expungement.<sup>249</sup>

## V. RESOLVING THE EXPUNGEMENT MESS

### A. THE TROUBLE WITH EXPUNGEMENTS

The public disclosure of un-adjudicated customer complaints by an industry or its regulator is unique to the securities field. This public disclosure of un-adjudicated customer complaints may seem unfair to brokers, but securities law and regulation, more than any other area of law, is grounded in full disclosure.<sup>250</sup>

In addition, because brokerage firms can enforce agreements to arbitrate disputes with their customers,<sup>251</sup> but for the existence of CRD and the FINRA reporting rules, the public would have no access to information about legal proceedings brought by customers.<sup>252</sup> The existence of court cases against doctors, lawyers, and accountants, for example, is a matter of public record. The fact that CRD provides easy public Internet access to information about arbitrations filed by customers of brokerage firms is unique in filling a significant gap in the public record.

This Article focuses on one aspect of CRD expungement—the process that FINRA uses to allow brokers to apply for expungement following settlement of an arbitration complaint. That process is flawed. FINRA’s repeated and continued attempts to adapt its arbitration system to the problem of expungement in settled cases have failed in every respect.

The issues associated with CRD expungement began in 1998 with the concern that arbitrators lacked the power to erase state records.<sup>253</sup>

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2011, cases coming to closure were already declining, yet expungement applications were still rising. See *Dispute Resolution Statistics*, FINRA, <http://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/AdditionalResources/Statistics/> (last visited Sept. 28, 2013) (“Arbitration Cases Closed by Year”).

249. See *Gilliam v. SagePoint Fin., Inc.*, No. 12-03717, 2013 WL 3963949, at \*5 (FINRA July 19, 2013) (“Until FINRA substantially clarifies Rule 2080, requests for expungement will multiply, resulting in many expungements FINRA never intended.”).

250. See Exchange Act §10(b), 15 U.S.C. § 78j (2012); Securities Act of 1933 § 12(2), 15 U.S.C. § 77l(2).

251. *Shearson/Am. Exp., Inc. v. McMahon*, 482 U.S. 220 (1987).

252. See *About BrokerCheck Reports*, FINRA, <http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/> (last visited Nov. 1, 2013).

253. See *supra* notes 67-73 and accompanying text.

That objection exposed many other problems—a lack of substantive standards and procedures and an environment in which arbitrators were granting expungement without making any inquiry whatsoever.<sup>254</sup> Aggrieved investors were being paid money to agree to the expungement of any records of their complaints.<sup>255</sup> Information of potential value to regulators, prospective employers of brokers, and the investing public was thereby disappearing from CRD.

After the moratorium was imposed in early 1999, FINRA spent over three years studying these issues.<sup>256</sup> Three Notices and several different proposals followed.<sup>257</sup> NASD Rule 2130 (now FINRA Rule 2080) became effective in early 2004.<sup>258</sup> The standards supposedly contained in that Rule were vague and over-lapping.<sup>259</sup> No procedures were articulated, there was no requirement of a hearing, and there were no provisions for regulatory input or meaningful judicial review.<sup>260</sup> Brokers were, however, provided with a mechanism to seek expungement through FINRA arbitration.<sup>261</sup>

When FINRA proposed Rule 2130, it told the SEC and its members that that Rule would insure that expungement—relief that was sometimes justified—would be granted only in extraordinary situations,<sup>262</sup> but that was not to be the case.<sup>263</sup> By 2007, it was apparent that the supposed articulation of the substantive standards changed nothing.<sup>264</sup> The eighteen expungements granted by arbitrators to Mr. Karsner were particularly problematic.<sup>265</sup> Then, the prospect of regulatory review and an opportunity for regulators to oppose expungement disappeared with the New York cases.<sup>266</sup>

In 2008, FINRA proposed another fix to its expungement procedures.<sup>267</sup> In Rule 12805, FINRA required that prior to

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254. See *supra* notes 75-82 and accompanying text.

255. See *supra* note 82 and accompanying text.

256. See *supra* Part I.B.

257. See *id.*

258. See *id.*

259. See *id.*

260. See *id.*

261. See *id.*

262. See, e.g., *supra* note 3.

263. See *supra* Part II.A-B.

264. See *id.*

265. See *supra* Part II.A.

266. See *supra* Part II.B.

267. See *supra* Part III.A.

recommending expungement, the arbitrators would have to hold a hearing and provide a “brief explanation of [their] reasons.”<sup>268</sup> The Rule also provided that arbitrators had to consider the amount of the settlement before granting expungement.<sup>269</sup> These additional safeguards were supposed to solve the problems.

However, FINRA was fooling itself. The requirement that arbitrators hold a hearing and make more specific findings was purely cosmetic.<sup>270</sup> Despite the statement in its 2008 Rule proposal that complainants could object to expungement by appearing before the arbitrators, FINRA had to be aware that these hearings would be informal, *ex parte*, one-sided presentations of evidence<sup>271</sup> because investors who have settled to, at least in part, achieve finality, appear very rarely.<sup>272</sup> Arbitrators hear only the broker’s testimony<sup>273</sup> and see only the documents that the broker (and the broker’s lawyer) wants them to see. The fact that the amount of the settlement must be considered adds some friction,<sup>274</sup> but other important items, like the broker’s

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268. FINRA MANUAL, RULE 12805 (2013).

269. *See id.*

270. Now, FINRA proposes to create even more expungement procedures for *ex parte* expungements. A rule filing is anticipated in late 2013. *See* Barlyn, *supra* note 11; Eaglesham & Barry, *supra* note 11. This new Rule, which would make it even easier for brokers to seek expungement, is supported by the Securities Industry Financial Markets Association. *See* Jamieson, *supra* note 5.

271. *See supra* note 208 and accompanying text.

272. *See supra* note 232 and accompanying text. The attorney or law firm that represented the investor was paid all that it will ever be paid for that case, and it too makes no appearance (even when the broker is asking the arbitrators to find that the investor and lawyer filed a claim that was “false”).

273. In some cases, the broker did not even testify and the “hearing” consisted of a lawyer’s presentation of evidence. *See, e.g.,* Weiss v. Nationwide Planning Assocs., Inc., No. 11-01164, 2011 WL 6886309 (FINRA Dec. 21, 2011) (including one dissenting opinion by an arbitrator, who, on that basis, disagreed with the granting of expungement).

274. *See* FINRA MANUAL, RULE 12805(b), *supra* note 33. FINRA does not provide statistics on the average amount of damages sought in an arbitration, the average amount of customer awards, or the average amount of settlements. However, given that FINRA requires reporting of virtually all customer-initiated arbitrations, many settlements lie in a range at or slightly above the cost of defense. Because of the requirement of Rule 12805(b), these complaints, which are no less likely to be valid or of informational value than are complaints in larger cases, are more likely to result in expungement than complaints in larger cases. One unintended side effect of Rule 12805 is that it encourages the expungement of complaints in small cases. *Cf. supra* notes 271-73 and accompanying text. (discussing, *inter alia*, the award in *Wexco Indus. v. UBS Fin. Servs., Inc.*, No. 11-01063, 2013 WL 653343 (FINRA Feb. 11, 2013)).

disciplinary history and record of prior arbitrations and expungement applications, are not required items.

With no complainant or prosecutor and no rule prohibiting a settling firm or broker from extracting an agreement that the investor will not oppose the expungement,<sup>275</sup> testimony and documents that might prove the truth of the customer's allegations remain buried in closed files.

FINRA's informal, ex parte expungement hearings have proven to be meaningless exercises.<sup>276</sup> No meaningful cross-examination, the basis of our truth-divining system, takes place in the vacuum of an ex parte proceeding.<sup>277</sup> At least 73% of the studied cases involved hearings that were merely telephonic. No matter how dedicated to the public interest an arbitrator might be and no matter how hard an arbitrator might try to evaluate the validity of a complaint, an ex parte arbitration hearing is unlikely to be anything more than a short, stylized affair.

The requirement for arbitrators to find that the case fits within one of the three broad categories that FINRA established adds no meaningful safeguard, and arbitrator awards reflect inconsistent interpretations of the categories.<sup>278</sup> Arbitrators just recite the denials that the broker offers during the ex parte expungement hearing.<sup>279</sup> Indeed, in some cases, the arbitrators' expungement award contains an explanation that the broker's attorney drafted or was the product of a Stipulation that accompanied the settlement.<sup>280</sup>

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275. FINRA expressed concern about purchased expungements, *see* NASD, NTM 01-65, *supra* note 3, but has never banned the practice of seeking an agreement not oppose expungement as part of a settlement. *But see* Barlyn, *supra* note 11.

276. *See, e.g.*, *York v. Morgan Stanley Smith Barney*, No. 11-03966, 2012 WL 4847068 (FINRA Oct. 2, 2012). The arbitrators attached to their award a stipulation, signed by the parties, reciting the grounds and basis for expungement. The award incorporates that stipulation word-for-word. *Id.*

277. In *Gilliam v. SagePoint Financial, Inc.*, the arbitrator complained that ex parte expungement hearings require "arbitrators to play devil's advocate to make sure the ex parte evidence . . . is reasonably vetted." No. 12-03717, 2013 WL 3963949, at \*3 (FINRA July 19, 2013).

278. *Id.* at \*4-6.

279. *See, e.g.*, *York*, 2012 WL 4847068.

280. *See* *Barker v. Sec. Am., Inc.*, No. 12-01305, 2013 WL 595840 (FINRA Feb. 26, 2013)

An especially good example of what is wrong with FINRA's expungement process is *Barker v. Securities America, Inc.*<sup>281</sup> In that case, twenty-two different brokers who were employed by Securities America collectively sought expungement relief.<sup>282</sup> This single arbitration resulted in the expungement of thirty-one separate arbitration cases.<sup>283</sup> In the expungement request, these brokers named only their employer as the Respondent, and the investors who made the complaints were not named.<sup>284</sup> All thirty-one expungements were granted after a single hearing session (completed in less than four hours).<sup>285</sup> The award does not indicate whether any testimony was taken from any of the twenty-two brokers, and it seems impossible that all twenty-two brokers gave sworn testimony before the arbitrator in that short time. The award recites that "the parties submitted a Proposed Award for the arbitrator's review."<sup>286</sup> The award that was entered appears likely to be the one that the "parties" proposed.<sup>287</sup>

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281. *Id.*; see also *Hyman v. Sec. Am., Inc.*, No. 12-02969, 2013 WL 2368505 (FINRA Aug. 5, 2013) (where expungement was granted en masse for six other Securities Americas brokers in less than a day); see also *Miller v. Sec. Am., Inc.*, No. 11-03509, 2013 WL 1933872 (FINRA May 1, 2013) (granting expungement of eleven separate arbitration complaints in a single half-day session); *Stief v. Advanced Equities*, No. 11-03116 (Apr. 27, 2013) (granting expungement in a single session for nine brokers); *Glubiak v. Sec. Am., Inc.*, No. 12-01156, 2013 WL 395553 (FINRA Jan. 23, 2013) (granting expungement of four complaints in a single half-day hearing).

282. See *Hyman*, 2013 WL 2368505 (granting expungement en masse for six other Securities Americas brokers in less than a day); *Miller*, 2013 WL 1933872 (granting expungement of eleven separate arbitration complaints in a single half-day session); *Glubiak*, 2013 WL 395553 (granting expungement of four complaints in a single half-day hearing).

283. See cases cited *supra* note 283.

284. See *id.*

285. See FINRA MANUAL, RULE 12000(n) (2013), Code Of Arbitration Procedure for Customer Disputes.

286. *Barker v. Sec. Am., Inc.*, No. 12-01305, 2013 WL 595840 (FINRA Feb. 26, 2013).

287. The State of Utah recently fined one of the brokers who received expungement in *Barker* for failing to supervise in a different case. Eight of the brokers already had CRDs that showed customer complaints. Two of these had more than one such complaint. The award does not indicate whether the panel that granted these twenty-two expungements was told any of these facts. The hearing was telephonic. In *Wayman v. Securities America, Inc.*, by contrast, an arbitration panel awarded \$1.2 million (including punitive damages) against Securities America in a case involving that same investment. No. 10-00012, 2010 WL 5552424 (FINRA Dec. 12, 2013). The law firm that represented the brokers in *Barker* represented Securities American in *Wayman*, suggesting that the arbitration proceeding in *Barker* was not very adversarial.

The requirement that arbitrators consider the amount of the settlement also fails to act as a meaningful safeguard. First, many arbitrations involve modest amounts of damages, often not much greater than the cost of an expensive legal defense. Many such (meritorious) complaints are undoubtedly being expunged, despite the requirement that the amount of the settlement be taken into account because the settlements can be justified by the potential cost of defense. Even in larger cases, FINRA provides arbitrators with no guidance other than that they should take the amount of the settlement into account.<sup>288</sup> In one arbitration, a \$160,000 settlement—which a dissenting arbitrator said approximated the damages incurred by the Claimant—nevertheless resulted in an award of expungement.<sup>289</sup> In another case, where \$96,000 was paid in settlement, the arbitrators explained away the amount of the settlement by writing that the payment to the investor was the least it would cost the broker to defend the allegations had a full-blown adversarial hearing been held.<sup>290</sup> By contrast, the entire expungement hearing—in which the Respondent ostensibly proved that the claim was

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*See id.*; *see also* *Barker v. Sec. Am., Inc.*, No. 12-01305, 2013 WL 595840 (FINRA Feb. 26, 2013).

288. While FINRA awards recite the amount sought in the Statement of Claim, they rarely mention the amount of settlement.

289. *See Lee v. Centaurus Fin., Inc.*, No. 11-03229, 2013 WL 1717763 (FINRA Apr. 8, 2013). There, an arbitration panel granted expungement on the ground that the broker was not involved in a sales practice violation. *See id.* The settlement agreement provided for a cash payment of \$160,000.00 and a “covenant whereby the Claimant was affirmatively obligated to assist the Respondent in having the customer dispute information expunged . . . .” *Id.* However, one arbitrator dissented, writing that the amount of the settlement “approximated the amount of the Respondent’s actual damages.” *Id.* This combination of facts shows that the problem with expungement was not solved by either the 2008 amendment or by FINRA’s training program.

290. *See Wexco Indus. v. UBS Fin. Servs., Inc.*, No. 11-01063, 2013 WL 653343 (FINRA Feb. 11, 2013) (following the settlement of a case that involved a net payment to an investor \$96,000, a FINRA arbitration panel granted expungement, ruling that the claims made by the investor were “false”). The arbitration award states that the panel heard testimony from the broker, reviewed twenty-five exhibits, and received respondent counsel’s explanation that the \$96,000 settlement was the least it would cost to defend the allegations had the case not settled. *See id.* One can only wonder what evidence the Respondent expected the Claimant to adduce that would have converted a three-and-a-half-hour ex parte hearing proving that the claim was “false” into a \$96,000 legal bill needed to defend an adversarial arbitration hearing. *See id.*

false—consumed only a single FINRA arbitration session.<sup>291</sup> It was, after all, *ex parte*.

No amount of arbitrator training can fix these flaws. Arbitrators can only make decisions based on the evidence they hear. Indeed, FINRA’s own training materials for arbitrators explain that an arbitrator’s function is to “determine the facts of the case, . . . evaluate the testimony and weigh to credibility of witnesses . . . .”<sup>292</sup> The absence of contradictory evidence in post-settlement expungement cases surely explains the 93.7% expungement rate.<sup>293</sup>

FINRA has also not fixed the issues associated with the confirmation requirement. The supposed purpose of confirmation was to provide an additional safeguard for regulatory and public interests.<sup>294</sup> The New York cases, however, show that no such safeguard exists because the expungement award is not subject to judicial review.<sup>295</sup> The *Karsner* decision, with its suggestion that awards styled as “recommendations” are not confirmable “awards,”<sup>296</sup> looms as an issue that FINRA has ignored.

There is yet another problem with the current system—one that has not yet appeared in the records, but that is beginning to appear in law offices around the country. When an investor commences an arbitration proceeding, the broker’s CRD is amended to reflect the complaint.<sup>297</sup>

291. *See id.*

292. *See* FINRA, DISPUTE RESOLUTION: BASIC ARBITRATOR TRAINING 110 (2013), available at <http://www.finra.org/web/groups/arbitrationmediation/@arbmed/@arbtors/documents/arbmed/p125416.pdf>. Indeed, these training materials state (in the context of contested proceedings) that “Affidavits are infrequently submitted in an evidentiary hearing for anything other than ministerial matters, like authenticating third-party records. If the panel, however, decides to admit an affidavit, the chairperson may state that its weight as evidence may be diminished, because the opposing party will not have a chance to challenge the truth of the statements it contains.” *Id.* at 99. The same can be said of everything that occurs at an expungement hearing.

293. In *Fabrizio v. Wells Fargo Advisors LLC*, No. 11-02293, 2013 WL 3365259 (FINRA June 26, 2013), an arbitrator dissented from an award recommending expungement, writing that the Statement of Claim “contained numerous specific allegations of unsuitable investments . . . . [The] dissent [does not] imply that any of the allegations in the Statement of Claim are true. Since the Panel was deprived of the opportunity to hear all of the facts through a full evidentiary hearing, there is no way to reach an informed conclusion on the truth or falsity of the allegations asserted.”

294. *See supra* text accompanying note 119.

295. *See supra* Part II.B.

296. *See supra* text accompanying notes 136-40.

297. *See* FINRA, FORM U4 UNIFORM APPLICATION FOR SECURITIES INDUSTRY REGISTRATION OR TRANSFER 11–12 (2009), available at <http://www.finra.org/>



The arbitration claim itself is not a public document, and BrokerCheck does not identify the complainant. However, an investor who then settles that claim may not realize that if expungement is sought and granted, that anonymous complaint on BrokerCheck would be erased and an award would be listed in the FINRA award database. That award will have the investor's name in the caption, and it is likely to contain a "finding" that the complaint was false or erroneous. The name of the lawyer who represented that investor will also appear in that award.<sup>298</sup>

Over time, lawyers will tire of having their names publicly associated with "findings" that the claims they file for their clients are false or erroneous. As such awards became ubiquitous, demands by settling brokers that include agreements not to oppose expungement may begin to discourage settlements.

In sum, no one should be surprised that expungements post-settlement are being granted at a rate of 93.7% of the cases in which expungement is requested. The conditions for such results are ripe. Regulators, prospective employers of brokers, and the investing public (and their lawyers) ought to be very concerned about this high expungement rate and the ease with which expungement is obtained. The relief that is supposed to be "extraordinary" is, in fact, virtually automatic. FINRA's reforms and supposed safeguards do not work. FINRA's arbitration-based approach to post-settlement expungement should thus be abandoned because it cannot function properly. A different system is desperately needed. In the next section, such a system is proposed.

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web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015111.pdf.

298. See, e.g., discussion *supra* note 290 (discussing *Wexco*); *Cheek v. Barmodihardjo*, No. 11-04165 (May 24, 2013). FINRA's procedures are already creating difficulty for investor and lawyers. Even though FINRA stated in NTM 04-16 that it considers the practice a violation of its rules, settlement offers are already being made conditional on a Stipulated Award for expungement or at least, an agreement to not to oppose expungement. Lawyers now have to make difficult decisions about what to tell their clients. See NASD, NTM 04-16, *supra* note 119, at 214. Both lawyers and clients should be concerned about either Stipulating that the complaint was false, agreeing to not to oppose the entry of such a finding or even without an agreement, an arbitral finding that the investor and lawyers filed a false complaint. Thus, the process that FINRA created may, in the end, discourage the settlement of cases.

### B. A BETTER APPROACH

Several changes are needed. First, there must be a requirement that regulators receive notice that a broker is seeking expungement *before* the issue is decided, not after. The notice should be given to FINRA, and FINRA should promptly send that notice to all state securities regulators to give any of them an opportunity to object right away.<sup>299</sup>

That pre-hearing notice requirement would serve several purposes. First, regulators knowledgeable about the purpose of the CRD and the “regulatory value” of customer dispute information would be in a position to evaluate the import of keeping a record of a complaint versus expunging it. Pre-hearing notice would give the regulators an opportunity to review the expungement application and check it against their files to see if they are already investigating the complaint. It would also give the regulators an opportunity to determine whether there are similar complaints against the same broker by other customers. When provided with notice, a regulator concerned about the expungement request can contact the complainant and attempt to elicit facts and obtain documents that will help inform the decision whether to oppose expungement. In addition, the regulators can, if they wish, use their broad subpoena powers to obtain information from the brokerage firm or the broker.

Second, the hearing procedures for obtaining these expungements must change. In cases where a regulator thinks expungement is inappropriate, a procedure must be created that enables a regulator to oppose it. Under current Rules, no such procedures exist. FINRA’s Division of Expungement and the states are only notified *after* the evidence has been presented to the arbitrator/fact-finder and a decision was made. Providing advance notice to FINRA enforcement and the states is the first step to enabling a real, rather than an illusory, expungement hearing.

Third, there is no good reason for arbitrators to be the decision-makers in post-settlement expungement situations. Not only are arbitrators unable to play the role of prosecutors and adjudicators, they are also not equipped to serve as guardians of the public interest. An arbitrator’s role is to resolve private disputes about money. An administrative law judge or other adjudicatory body created under the

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299. Currently, FINRA sends that notice to the states only after the award is rendered when the case is moving to the confirmation stage. *See* NASD, NTM 01-65, *supra* note 3.

aegis of a regulator is better-suited than an arbitration panel to the task of evaluating the importance to the public interest in expungement than is an arbitration panel. Both FINRA and the states already have units that can address and adjudicate expungement issues properly and can account for the actual regulatory interest in preserving or expunging a complaint.<sup>300</sup>

Placing the decision in the hands of regulators also has additional benefits. First, there would be no question about the enforceability of the outcome in light of *Karsner*.<sup>301</sup> Second, there would be no need for a two-step process, such as the one that now with arbitration hearings followed by judicial confirmation. Third, a broker who believes expungement was wrongly denied can appeal and obtain “substantial-evidence” review,<sup>302</sup> a procedure not available for arbitration awards. Finally, decisions made by regulators and courts would foster the development of useful legal principles, benchmarks, and guidelines. Right now there are none.

Alternatively, FINRA could provide that post-settlement expungement requests be made directly to a court, restoring the moratorium for settled cases.<sup>303</sup> A recent case from California demonstrates that such a system would work well.<sup>304</sup> In *Lickiss v. FINRA*, broker Edwin Lickiss sought the expungement of seventeen

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300. See FINRA, GUIDE: DISCIPLINARY HEARING PROCEDURES, available at <https://www.finra.org/web/groups/industry/@ip/@enf/@adj/documents/industry/p006757.pdf>. Efficiency nevertheless dictates that in cases that don’t settle, arbitrators should remain empowered to decide on expungement based on findings, *i.e.*, that the claim was false.

301. See discussion *supra* Part II.A.

302. FINRA’s rules provide a right to appeal an adverse decision of one of its Hearing Panels, and a firm or individual can appeal FINRA’s action to the SEC and then to a federal court. See *Adjudication*, FINRA, <http://www.finra.org/Industry/Enforcement/Adjudication/> (last visited July 16, 2013); see also 5 U.S.C. § 706(2)(E) (2012).

303. Cases that proceed in arbitration to an adversarial hearing should be excepted from the moratorium. In such cases, the main problem with post-settlement proceedings (*i.e.*, their *ex parte* nature) is not present.

304. The concept of proceeding in court and skipping arbitration is not new, and indeed, is contemplated (although it is discouraged) in FINRA Rule 2080(b)(2). *But see*, Dan Jamieson, *Expungement Ruling Could Have Wide Impact*, INVESTMENT NEWS (Sep. 2, 2012, 12:01 AM), <http://www.investmentnews.com/article/20120902/REG/309029985>.

customer complaints from the 1990s.<sup>305</sup> Instead of proceeding in arbitration, the broker skipped arbitration and applied directly to a court for expungement.<sup>306</sup> The broker asserted that the claims on his CRD were more than twenty years old, that his regulatory record since then has been clean, and that each of the complaints arose from a single investment for which the broker was paid an “ordinary commission.”<sup>307</sup>

Lickiss’ action, which named FINRA as a defendant, sought to invoke the court’s general equitable powers to grant expungement.<sup>308</sup> FINRA opposed the application on the ground that expungement could only be obtained if the one of the three Rule 2080 grounds was pled and established.<sup>309</sup> The lower court vacillated, but an appellate court eventually ruled that the FINRA Rule 2080 categories did not apply to the court because they were intended to be procedural rather than substantive.<sup>310</sup> Instead, the court ruled that its inherent equitable powers had been properly invoked, and the case was remanded to the trial court for a hearing on whether expungement is justified.<sup>311</sup> The court’s decision did not specifically define the standard for the lower court to apply, but it did cite the SEC’s 2003 pronouncement that expungement was justified when the information “lacks regulatory value.”<sup>312</sup>

On remand, the lower court declined to grant any expungements. The court framed the issue in terms of the public’s right to know about Mr. Lickiss’s past.<sup>313</sup> The court observed that: Mr. Lickiss was the

305. See *Lickiss v. FINRA*, 208 Cal. App. 4th 1125 (Cal. Ct. App 2012).

306. *Id.*

307. *Id.* at 1131.

308. *Id.* at 1128.

309. *Id.* at 1134.

310. *Id.* Rule 2080, by its terms, only states the conditions under which FINRA will waive notice and the requirement that FINRA be named a party in an application to confirm an expungement award. See FINRA MANUAL, RULE 2080(b)(1) (2013). The court in *Lickiss* found that Rule 2080(b)’s categories do not expressly limit a court’s equitable power to grant expungement to FINRA’s three categories. See *Lickiss*, 208 Cal. App. 4th at 1134. The “equitable power” of courts was held to be broader than that defined by the three categories listed in Rule 2080. *Id.*

311. See *Lickiss v. FINRA*, No. N11-0457 (Cal. Super. Ct., Oct. 18, 2013).

312. *Lickiss*, 208 Cal. App. 4th at 1129.

313. *Lickiss*, No. N11-0457, at 2 (quoting *State v. Ambaye*, 616 N.W.2d 256, 261 (Minn. 2000), a case that the appellate court in *Lickiss* “approvingly” cites). The *Lickiss* court also cited a comment letter that Laurence Schultz of the Public Investors Arbitration Bar Association wrote when Rule 12805 was proposed in 2008. See *Lickiss*, No. N11-0457, at 3 (citing Letter from Laurence S. Schultz, President, Pub. Investors Arbitration Bar Ass’n, to Nancy M. Morris, Secretary, SEC (May 16, 2008), available at <http://www.sec.gov/comments/sr-finra-2008-010/finra2008010-11.pdf>). The letter

subject seventeen separate arbitration claims between 1991 and 1996, involving approximately \$1.5 million; the claims involved “serious allegations of egregious misconduct, including fraud; two of the cases went to hearing, and Lickiss lost in both; and the other fifteen cases settled for over \$800,000. The court wrote:

There are strong reasons for these repeated claims of serious misconduct to remain part of the public record. The public interest is best served when investors and regulators have complete access to accurate info regarding the prof history of registered representatives. . . . [As grounds for expungement, Mr. Lickiss] points first to the age of the complaints . . . . While it was clear from [his] testimony that [his] conduct is the source of great personal shame and embarrassment for him, the public, brokers and regulators still have a real need to know that they occurred.<sup>314</sup>

The *Lickiss* court’s determination, based principally on the regulatory value of the information and the public’s right to know, provides a more straightforward and appropriate approach than FINRA’s three-category approach in Rule 2080.<sup>315</sup> The three categories that FINRA now uses (“clearly erroneous,” “not involved,” or false) are vague and overlapping.<sup>316</sup> The standard for post-settlement expungement should be redirected toward the questions of investor protection and the integrity of CRD. Indeed, FINRA Rule 2080(b)(2) provides:

[U]nder extraordinary circumstances, [FINRA] may waive the obligation to name FINRA as a party if it determines that (A) the expungement relief and accompanying findings on which it is based are meritorious; and (B) the expungement would have no material adverse effect on investor protection, the integrity of the CRD system or regulatory requirements.<sup>317</sup>

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describes CRD and BrokerCheck as containing information “about a broker to whom [investors] are considering entrusting their life’s savings. . . . The accuracy and integrity of the system are of utmost importance to the public.” *See id.*

314. *Lickiss*, No. N11-0457, at 3–4.

315. *But see id.* (noting that Lickiss did not assert that the claims against him were false or erroneous).

316. *Id.*

317. FINRA MANUAL, RULE 2080(b)(2) (2013), Obtaining an Order of Expungement of Customer Dispute Information from the Central Registration Depository (CRD) System. *Cf.* Kevin J. O’Brien, *Fact Finder to European Court Backs*

Imposition of that standard—across the board—would make the expungement process leaner and more logical.

The last proposed change is to achieve the long-stated goal that expungement post-settlement be extraordinary. FINRA and the states should provide that the burden of proof on a broker seeking expungement should be one of “clear and convincing evidence.”<sup>318</sup> Administrative law judges, hearing officers, and/or courts should consider whether this burden has been met and articulate the reasons for their decision. Only then will expungement be the extraordinary remedy that FINRA intended.

### CONCLUSION

FINRA Rules should provide that if a matter is settled prior to the commencement of hearings, then all applications to expunge must be made to FINRA’s Division of Enforcement. FINRA would, as it does now in the context of the confirmation proceeding, notify the states. The advent of timely and meaningful notice to regulators, their direct involvement in post-settlement expungement requests and hearings before regulatory bodies rather than arbitrators, the use of a “regulatory value/public interest” standard, and an appropriately-high burden of

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*Google in a Spanish Privacy Battle*, N.Y. TIMES, June 25, 2013 (citing a policy of Spanish Data Protection Agency to seek deletion deletions of information on the internet pursuant to the 1995 European Union data protection law in cases where “the information was ‘obsolete, lacked any relevance or public interest, and where widespread dissemination would lead to the harm of the applicant’”). The Article reports that a recommendation has been made to the European Court of Justice that rejects Spain’s policy. According to the Article, the recommendation states that “the 1995 law ‘does not entitle a person to restrict or terminate dissemination of personal data that he considers to be harmful or contrary to his interests’ and that the recommendation concluded that “wishing to eliminate embarrassing information is not reason enough to redact public records via Google.”).

318. In *Gilliam v. SagePoint Financial, Inc.*, the arbitrator adopted just such a standard. No. 12-03717, 2013 WL 3963949 (July 19, 2013). Indeed, even as FINRA was amending its rules in 2008 to supposedly strengthen the expungement process, NASAA was advocating just such a heightened evidentiary standard in order to limit expungements as “an extraordinary remedy.” Letter from Karen Tyler, *supra* note 210 (“To partially address this issue, NASAA would advocate for the creation of a presumption against expungement. Expungement is, and always was, intended to be an extraordinary remedy . . . . By creating a heightened evidentiary standard for those requesting expungement, expungement will in fact be an extraordinary remedy.”).

proof would all provide a more appropriate, efficient, and logical process than FINRA now employs.

The three interests at the intersection of the expungement controversy will finally be addressed. The state regulators, whose interests have been virtually emasculated since 2003, will be reinvigorated. The public will be assured the clean record of their broker or financial advisor has not been bought. Finally, the brokers who settle cases will still have a place to go for a single, fair, efficient, and final adjudication of whether investor complaints belong on their CRD records.