PIABA BAR JOURNAL

VOLUME 27, NO. 3 • 2020

a publication of

Public Investors Advocate Bar Association

PIABA BAR JOURNAL

VOLUME 27 | 2020 | NO. 3

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VETTING CASES AND DRAFTING A SECURITIES ARBITRATION CLAIM: THE KEYBOARD IS MIGHTIER THAN THE MARKET*

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I. Introduction

There is no magic to drafting a securities arbitration claim. Indeed, crafting an effective statement of claim is an art, and there are as many ways to tell the story as there are storytellers. As an attorney representing investors who suffered losses in their brokerage accounts, it is your task to persuade whoever is in charge of the purse strings to compensate your aggrieved clients. That could be the in-house lawyer of the brokerage firm, the business people at the branch office where the misconduct occurred, your opposing counsel, a panel of one to three arbitrators, a mediator and sometimes even an insurer.

In order to position your clients for the most beneficial outcome, whether you are aiming for a pre-filing resolution or preparing to take your case through a final hearing, you must begin with a well-articulated and convincing statement of claim.

Knowing both your client and your client's case from the onset as well as anticipating any defenses that may be raised will greatly increase your odds of recovery at any stage. While there is no one-size-fits-all template to drafting a securities arbitration claim, seasoned lawyers know that certain steps taken, and pitfalls avoided, can maximize your chances of successful results.

II. Case Evaluation and Intake

The most important task a Claimant's attorney can do is to vet the viable claim and choose the right cases to file. Knowing what cases to reject is just as important as knowing what cases to file. Not every client who loses money in the stock market has a claim against their broker or brokerage firm. Key considerations are: knowing the pertinent facts about the client; the prospective Respondents; the investments sold; and, the strategy pursued before accepting the representation.

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*This article is an update of an article that appeared in the PIABA Bar Journal 18 No. 3 PIABA B.J. 333 (2012).

Accepting clients before adequately evaluating the claims can have serious repercussions. You are not doing your clients a service if you bring a case which has no merit. Nor are you burnishing your reputation with defense counsel when you bring a frivolous claim. It also affects your bottom line, since most investor counsel are retained on a contingency fee basis. How can you engage in adequate evaluation at this stage?

A. The Client Interview: Know your Client

Just as FINRA Rule 2090 requires the broker and firm to know their customers ("KYC"), you, as his or her counsel, should know your client.[1] And, you should know them better. Nothing is more humbling than first learning from your opposing counsel about your client's notorious career as a professional poker player or about the mezzanine financing capital she raised for a start-up she formed with her private equity pals. The best starting point is a thorough interview with your client in which you ask the questions that the broker should have asked.

Give your client the FINRA Rule 2111[2] (suitability) and FINRA Rule 2090 (KYC) examination by asking their: age, marital status, education, employment experience, prior investment experience, risk tolerance, investment horizon, tax bracket, number of dependents, where the money originally came from and the like. This interview should be followed-up by a review of your client's relevant tax returns, monthly statements and new account forms from the brokerage firm, as well as other outside brokerage account statements and new account forms.

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1. FINRA Rule 2090 states that "Every member shall use reasonable diligence, in regard to the opening and maintenance of every account, to know (and retain) the essential facts concerning every customer and concerning the authority of each person acting on behalf of such customer." FINRA, Rule 2090 (2020).

2. Under FINRA Rule 2111(a) "A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation." FINRA, Rule 2111 (2020).

If your client does not have these documents in his/her possession, have that client sign a letter of authorization to be sent to all of the firms at which securities accounts were maintained allowing the release of these statements and new account forms to your office. Old tax returns can be obtained by your client from their accountant or taxing authority. If your client is reticent about disclosing tax returns, a red warning light should go off.

If your clients owned a joint brokerage account, make sure that you collect the relevant information from both account owners. If you are representing someone who gave a power of attorney to another, or if your client is a trust, you must interview the representative parties as well and obtain the relevant documents from these individuals. You must also understand the nature of the trust, and the powers and duties of the trustee, as well as any trading restrictions on the trustee or attorney-in-fact.

Similarly, if your client is a corporate entity or partnership, you should delve into the finances of the entity, the prior trading history of the controlling officers of the entity and understand who has authority over the entity or could approve the opening of the account or its trading. The same analysis should be done of the controlling officers and investment advisors. Also, if there are board minutes or other committee minutes (such as those from an investment committee) make sure you review them prior to drafting the claim. Often, the broker will have made presentations to such a board or committee and it is important to understand what was presented to and considered by the members.

By determining the scope of authority prior to drafting the claim, other violations by the brokerage firm may become apparent - such as lack of the entity's authority to engage in certain securities transactions or the lack of the agent's authority to effect the transactions at issue. This will also assist you in deciding who should enter into any retainer fee agreement with you on behalf of any account owners, trusts or entities.

B. Know Your Story

There are two distinct parts to a securities arbitration claim:

- The first is the "people" part, which encompasses the interactions between the broker, brokerage firm and the client; and
- The second is the trading of the investments in the account and the degree of supervision of the account.

While the trading and information in the new account documents regarding suitability are easily verifiable by looking at documents, client-broker interactions are generally not. Ask your potential client to tell you the "story" of what happened from beginning to end. That will provide needed context to the trading at issue. When conducting the client interview, don't be afraid to ask "tough" questions; you will need to anticipate the defenses which the brokerage firm may raise.

Next, "test" the veracity of these facts. You can accomplish this by taking the following steps:

- Collect *all* of the correspondence (emails, letters and texts) between the client and the broker to see what was discussed.
- While most often times the client's interactions with the broker are verbal, see if your client has any notes to support the facts.
- Ask if there are any calendar entries to support the dates of the discussions with the broker.
- Determine if there were any witnesses to the discussions or meetings. To the extent that your case may turn on the testimony of any third-party witnesses, you should contact those witnesses (to the degree that the potential witnesses are not current employees of the Respondent) prior to filing.

Many arbitrations turn on witness credibility. Probe your client on the aspects of his or her personal life that may become relevant in the arbitration and may bear upon his or her credibility:

- Have they ever been arrested?
- Have they been involved in litigation prior to this?
- Have they ever had issues with taxing authorities?
- Do a quick Google search to see if your client's name comes up in connection with anything that may be deemed harmful to them.
- Look your client up on LinkedIn to verify his/her stated employment and educational background.
- At this stage, it is beneficial to get all of your client's social media accounts and peruse them for public information.

You can be sure that an experienced defense counsel (and most are) will be doing the same upon receipt of your claim.

C. Know Your Broker, Branch Manager and Firm

Other than your own client, the most important witness will be your client's broker. Therefore, prior to drafting your claim, look up the broker's Central Registration Depository ("CRD") record. The Web CRD, operated by FINRA, is the central licensing and registration system for the U.S. securities industry and its regulators. It can be accessed at www.finra.org/Investors/ToolsCalculators/BrokerCheck.

BrokerCheck contains the registration records of more than 3,800 registered broker-dealers and the qualification, employment and disclosure histories of more than 630,000 active registered individuals, including branch managers.[3] For investment advisors, the IAPD website contains similar information.[4]

While not all reportable information is listed in the Web CRD,[5] reportable customer complaints and regulatory actions against the broker will appear on this site. Terminations and bankruptcies are also reported, as well as the list of states in which the broker is or was licensed and the dates of such licensing. You want to review these dates to determine if the broker was licensed in the state in which your client was living when the transactions at issue took place.

If you know the name of the broker's branch manager, do a search for this person as well. If the manager was named or involved in arbitration claims where there were allegations of failure to supervise, this fact may be relevant to your case analysis.

CRDs also reference regulatory actions, including any Acceptance, Waiver and Consent ("AWC"). An AWC is a settlement between the brokerage firm and/or broker and FINRA consenting to a penalty (e.g., a fine or agreement to cease conduct which the regulators alleged breached the securities laws). Such regulatory activity is helpful to evaluate a potential claim as it generally shows that certain actionable misconduct repeatedly occurred at the brokerage firm.

The SEC also has a database to look up individuals who have been named in federal court actions or SEC administrative proceedings.[6] Individual states likewise have their own securities broker data bases that may contain additional helpful information.[7] These public records should be requested and reviewed

3. https://www.finra.org/investors/brokercheck-faq.

4. https://adviserinfo.sec.gov/.

5. FINRA, Rule 8312 (2020).

6. https://www.sec.gov/litigations/sec-action-look-up.

7. https://www.nasaa.org/contact-your-regulator/.

as well. Some states provide more information than others, so the experienced practitioner may wish to request CRDs from certain other states in which the broker is licensed, even if neither the client nor broker lives in those states.

Finally, do a Google search of the broker and check his/her social media accounts. You might find some gems that will help you in your case.

D. Know Your Investment

You should also know and understand the client's investments and the broker's strategy. Complex investments or strategies are oftentimes the subject of securities arbitrations. Today, more than ever, there are new investments and investment strategies invented by creative investment bankers. Market events, "black swan" occurrences or other economic or political turmoil may affect the performance of such investments. If you are dealing with an exotic or particularly complicated investment product, engage an expert to discuss how the investment worked and why it failed.

You should also ask your client for any literature, sales material, quarterly reports and prospectus received when the investments were made or provided by the investment sponsor. Review these documents to determine whether the risk tolerance stated in the materials was consistent with your client's stated investment objectives and risk tolerance. These may contain some helpful nuggets.

For example, illiquid investments should not be sold to customers with a need to access their money. Leveraged investments contain additional risk which may not be consistent with an investor who has a low to moderate risk profile and equity mutual funds may very well be inappropriate for someone living on a fixed income. With investments such as private placements or other types of unregistered securities, check to see whether this was an investment which required your client to be an "accredited investor," requiring the client to be both sophisticated and able sustain the risk of loss.[8] Then, see if they actually met the standards to invest.

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8. An accredited investor, in the context of a natural person, includes anyone who:
•earned income that exceeded $200,000 (or $300,000 together with a spouse) in each of the prior two years, and reasonably expects the same for the current year, OR
•has a net worth over $1 million, either alone or together with a spouse (excluding the value of the person's primary residence.). 17 C.F.R. § 230.501 (2020).

E. Know Your Claim

At the client intake phase, you need to understand if there is a viable legal claim. Although a client may arrive with a $1 million investment which became worthless—those facts alone don't give your client the right to bring an action. Add a few more facts, though, and it may be. If the investment was unsuitable or represented 100% of an account's portfolio, these facts could constitute actionable claims for unsuitability or overconcentration.

Similarly, there could be egregious facts, but no losses. For example, the broker might have made unauthorized trades which resulted in a gain for the client. Make sure you review the account statements and do a quick analysis of the losses to ensure that there are damages. Often, if improper trading in the account went on for a number of years, it is difficult to ascertain the amount of money lost. Sometimes, a client may believe that he/she has suffered losses, when in fact those losses were the result of the client's withdrawals from the account. Ask for all brokerage firm year-end statements for the years of the conduct at issue. By examining these documents for the trading (buy and sell) summary, cash deposited, cash withdrawn and value of the account at year-end, you can get a rudimentary understanding of the losses before going further.

If a case has particularly complicated trading, a long investment history or has complex strategies which were employed (making it hard to determine how the losses were incurred), retain an expert to prepare a profit and loss statement ("P&L") for your client before taking the case. Many times, this P&L can help determine where the losses were incurred and assist in showing trading patterns which could be helpful to your case analysis.

F. Know Your Chances of Collection

A strong case on the merits is only as good as its collectability. If you are considering a claim against a small brokerage firm or investment advisor, make sure that, if you are successful, there is a way for your client to get paid. SEC's Rule 15c3-1[9] - the "Net Capital Rule" - requires brokerage firms to maintain certain levels of their own liquid assets. The minimum net capital a firm must have on hand depends on its size and business.

Often, a smaller firm may only act as an introducing broker, meaning that the firm accepts your client's buy and sell orders, but has an arrangement with

9. 17 C.F.R. § 240.15c3-1 (2020).

a carrying firm (known as a clearing firm) to maintain custody of customer assets. Because a carrying firm has custody of customer assets, it must maintain higher levels of net capital than introducing firms.[10] If you have a claim against a smaller firm, such as one with only one branch or two offices, or against an introducing firm, look up the firm on FINRA BrokerCheck (*see* section II C) to determine if it is still registered. If it is no longer registered, this is a sign that you probably should go no further. You can also look up a firm's most recent financial statements by looking at its FOCUS report on the SEC's Edgar website.[11]

G. A Word About Fee Agreements…..

Once you have vetted your case and decided to sign up the client, you must enter into a fee agreement. A thorough discussion of fee agreements could be the subject of an entire treatise. For the purposes of this article, however, there are some important points to be highlighted. The individual state bars have specific rules governing fee agreements and it is important to review those rules when being retained. Some states have sample fee agreements on their websites. Here are some suggestions:

1. Make sure all owners on all of the accounts at issue are signatories to the fee agreement. If an account owner is a trust or corporate entity, make sure the proper representative is signing. Custodial accounts must be represented by a custodian.
2. Spell out clearly and in detail the nature of your representation. Most commonly, you are being retained "to investigate and file potential arbitration claims in FINRA against [brokerage firm] and [broker]".
3. Include any additional fees or percentage charges for appeals and collection work if you will be doing this work as well. Otherwise, state that you will not be responsible for this portion of the case.
4. Include a provision on costs as separate from fees.
5. You will need to decide whether to take the case on contingency, at an hourly rate, for a fixed fee or a blend of these arrangements. If hourly or blended, set forth the hourly rates of the attorneys and paralegals who will be working on the case.

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10. https://www.finra.org/investors/alerts/if-brokerage-firm-closes-its-doors.

11. EDGAR is the Electronic Data Gathering, Analysis and Retrieval system used at the SEC. https://www.sec.gov/edgar/searchedgar/companysearch.html.

6. Given that settlements are often subject to tax reporting, it is also a good idea to include a provision that clearly states that you are not providing any tax advice.
7. If you want the ability to hire local counsel (which some FINRA hearing jurisdictions require), include a provision on how that counsel will be compensated.
8. Importantly, some states, such as Florida, have fee-shifting provisions in their securities fraud statutes.[12] If a fee shifting statute applies, make certain that the fee agreement discloses this risk in the event that the client decides to proceed on a fee-shifting statute.
9. Finally, make sure you have all of your client's contact phone numbers, email addresses and residential addresses so that you know how to best contact him/her as the case progresses. You will also need this information when filing the Statement of Claim electronically with FINRA.[13]

III. Drafting the Statement of Claim

Now that you have vetted and signed up your client, you can begin the process of claim drafting. At this point, most of the hard work should have already been done. Focus on these two questions:

(1) Who will be reading your Statement of Claim? and

(2) What might you need to include to persuade those readers of the merits of your case?

A. Who is Your Audience?

There are a number of factors to consider when putting pen to paper (or keystrokes to e- document). Keep in mind just who the ultimate audience will be. You are not just drafting for the Respondents themselves, but rather a whole host of readers, any of whom might influence the ultimate decision in your action.

12. Fla. Stat. § 517.211(6) (2020).

13. FINRA has a filing portal platform on which the Statement of Claim can be filed. https://www.finra.org/arbitration-mediation/dr-portal.

These readers may include:
(1) in-house counsel;
(2) (outside) defense counsel;
(3) broker-dealer management;
(4) an insurer;
(5) one or three diverse arbitrators;
(6) a mediator; and,
(7) regulators.

Each audience category has a different agenda and each will view aspects of your claim differently. Remembering who your readers will be can assist you in focusing your attention on the areas that each party will likely seize upon in making a decision in your case.

1. Who will get your case: Early Dispute Resolution Team, Inside Litigation Lawyer or Outside Law Firm?

While there are no guarantees as to the route your claim will follow, the experienced Claimant's attorney can measure certain variables in drafting a claim to anticipate how the case will be "triaged" when it lands at the Respondent brokerage firm. What happens to your claim, and who handles it, will affect the pace at which it is resolved, the manner in which it is resolved and how much (if any) the offered resolution may be.

Certain allegations might make it more likely for the case to be referred to outside counsel versus being handled internally. In-house counsel must make a decision early on how your case will be defended. Will it retain outside counsel who will be compensated hourly (or on retainer) for defending the action and, therefore, have an incentive to spend more time and effort in litigating the case? Or, will it be handled in-house, and perhaps proceed in a different fashion without getting as much individual attention?

While transferring your case to outside attorneys may ensure that it gets more individual attention, it may also mean more costly and combative tactics. In most cases, it also means that there is little hope for an expeditious resolution. You should determine early whether you believe that in-house or outside counsel will be most effective in the final resolution of your case, and, if possible, tailor your claim accordingly.

a. The Pre-Filing Demand Letter

Generally, with a pre-filing demand, the case stays inside the brokerage firm and is handled internally. Many larger brokerage firms have early dispute resolution teams, whose task it is to get claims resolved at this level. While it is sometimes easier to get a smaller matter resolved through this route, the pre-filing settlement of a larger claim is rare. Unless you have a particularly egregious situation coupled with the happenstance of getting the right in- house lawyer's ear, your chances of early resolution are slim.

That being said, it is still not a bad idea to attempt to settle a particularly noxious case, or just a small one, pre-filing. If you decide to go this route, a fully articulated Statement of Claim provided to the brokerage firm but stamped "draft for settlement purposes only" will go a long way in assisting the decision-makers in an early evaluation of your client's claims.

A well-drafted Statement of Claim is quite helpful if you are aiming for a pre-filing resolution. First, it lets the in-house people know that you are ready to file a claim if there is no resolution. Second, there is simply no substitute for putting the facts down in a narrative fashion so that everyone can see just how badly your client was wronged, by whom and in what compensable way. Drafting a Statement of Claim can also help you refine your case. Working with your client to get all of the salient facts on paper will focus the issues and allow you to see many of the strengths and weaknesses of your claim at an early stage in the process. In this way, you, as the Claimant's attorney, are better equipped to evaluate the case from a settlement standpoint.

At the pre-filing stage, several things may make your claim more likely to resolve. The relative size of your claim and potential settlement target are important factors. FINRA member firms are required to report all claims involving a broker otherwise referred to as an "associated person" that are settled for more than $15,000.[14] Even if the broker is not named in the case

14. FINRA requires that the member broker-dealers report to FINRA when it receives notice that an associated person (broker) "is a defendant or respondent in any securities-or commodities-related civil litigation or arbitration, is a defendant or respondent in any financial-related insurance civil litigation or arbitration, or is the subject of any claim for damages by a customer, broker or dealer that relates to the provision of financial services or relates to a financial transaction, and such civil litigation, arbitration or claim for damages has been disposed of by judgment, award or settlement for an amount exceeding $15,000. However, when the member (firm) is the defendant or respondent or is the subject of any claim for damages by a customer, broker or dealer, then the reporting to FINRA shall be required only when such judgment, award or

caption but appears in the body of the demand letter or Statement of Claim, this reporting requirement applies.[15] Similarly, that same reporting requirement applies if the firm can reasonably determine that a demand letter or Statement of Claim involves a particular broker even if that broker's name is nowhere in the body of the letter or claim.[16] If a firm can resolve your case under this reporting limit, this may be an impetus for an early pre-filing resolution.

Certain hallmarks that the case may be indicative of a larger issue at the brokerage firm may also make pre-suit settlement more likely.

- Things such as a broker's sale of an unsuitable investment to all of his or her clients may be settled early to avoid publicity stirring up other complaints.
- Similarly, a product case where a proprietary investment blew up may be settled early so as to keep a lid on the problem.
- Press sensitive claims, regardless of their size, are also more likely to be resolved pre-filing.
- If you represent a well-known athlete or personality, or simply a highly regarded person in your community, there is a public relations benefit to the firm for the early settlement of the claim in return for a confidentiality agreement.

Make sure that these "important" facts are highlighted either in the draft claim or a cover letter sent with the claim.

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settlement is for an amount exceeding $25,000. FINRA, Rule 4530(a)(1)(G) (2020).

15. Note that FINRA's instructions for form U-4 disclosures of claims requires that the firms answer questions 14I(4) or 14I(5) "yes" if the individual was not named as a respondent/defendant but (1) the Statement of Claim or Complaint specifically mentions the individual by name and alleges the individual was involved in one or more sales practice violations or (2) the Statement of Claim or Complaint does not mention the individual by name, but the firm has made a good faith determination that the sales practice violation(s) alleged involves one or more particular individuals. https://www.finra.org/sites/default/files/AppSupportDoc/p015111.pdf.

16. *Id.*

b. The Filing Stage

Most cases are simply filed without a pre-filing demand. Claimant's counsel should consider the following issues which determine the route your claim will take once it is filed as a formal arbitration.

1. Size matters

The sheer size of a claim is a factor. A million dollar claim is more likely to justify the use of an outside lawyer from a pure cost perspective. If your client has lost a million dollars, but the compensable portion of the claim is really only a fraction of this, you may want to consider keeping your claims narrowed to the limited issue and demand the more realistic number to keep the case in-house. This will earn you credibility with Respondents and the arbitrators and may streamline any proceedings and shortcut anticipated defenses, making it easier for the case to stay in-house.

2. Product cases

There are always new investments and investment strategies created by investment bankers. These types of investments often perform as they were intended. However, sometimes they don't.

Proprietary investments "gone bad" often warrant the use of outside defense counsel. Complex investment strategies such as the use of affiliated credit facilities, loans against securities accounts or reverse repurchase agreements for the financing of securities may also mean the case gets sent to outside attorneys.

Similarly, leveraged products like Exchange Traded Notes ("ETNs"), Exchange Traded Funds ("ETFs") or other leveraged mutual funds may be referred to a big law firm to handle. So, too, for illiquid investments such as private placements, unit investment trusts, real estate investment trusts, promissory notes and annuities.

3. Don't give away your age

The apparent age of the claim may also be reason for a case to go "outside." If the claim is drafted so that it appears on its face to fall outside of the six-year

FINRA eligibility rule,[17] outside counsel may be retained to file a motion to dismiss in order to prevent the matter from being arbitrated at all.[18]

If your client purchased the investment more than six years prior to the filing of the Statement of Claim, your opponent will be instructed to move to dismiss the case even though the date of purchase is not the automatic triggering event. Where the facts deem it appropriate, Claimant's counsel should allege an ongoing fraud, wrongdoing after the purchase of the investment, or another continuing wrong (again, where the facts justify this) so that it is clear from the your Statement of Claim that the claim falls *within* the six-year eligibility period.

For example, fraud may go on for years, span several brokerage firms and may not be detected until a market downturn. Likewise, until there is a product failure, the impropriety of an investment may not have been detectable, which could be well after the purchase date. An ongoing fraud - lulling the Claimant into a false sense of security - should be pleaded where applicable to avoid an obvious eligibility defense. Similarly, a hold recommendation in the face of clear evidence that a recommendation to sell should have been made may breathe new life into an older claim.[19]

In a scenario where an investment was purchased more than six years prior to the claim, the experienced Claimant's counsel knows to uncover such facts as to demonstrate subsequent wrongdoing. Additionally, facts demonstrating the separate tort of fraudulent concealment within the six-year eligibility period

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17. Rule 12206 of the FINRA Code of Arbitration Procedure, FINRA's eligibility Rule, requires that the occurrence or event giving rise to a claim must have occurred within six years from the date of filing. FINRA, Rule 12206 (2020). The meaning of the "occurrence or event" language has been the subject of much litigation and interpretation, with most courts rejecting claims that the occurrence date is the date of purchase. *See*, *e.g.*, *Kidder Peabody & Co. v Brandt*, 131 F 3d 1001, 1004 (11th Cir. 1997); *Osler v. Ware*, 114 F. 3d 91, 91 (6th Cir. 1997.).

18. The FINRA Code of Arbitration Procedure, prohibits motions to dismiss except in narrow circumstances. One of these circumstances in the six-year eligibility rule. FINRA, Rule 12504(c) (2020). The FINRA rules only allow such motions to be made within 60 days of the final hearing, and impose a fee-shifting provision to the movant if such a motion is made in bad faith. FINRA, Rule 12206 (2020).

19. Rule 2111 of the FINRA Code of Arbitration requires that all recommendations from a broker to his customer be suitable. This rule specifically covers recommended "investment strategies." Investment strategies include a broker's recommendation to hold a particular security or maintain a particular investment strategy. *See* FINRA, Regulatory Notice 12-25, 2012 (May 18, 2012).

(such as carrying a false value of an investment on a monthly statement) may also assist in avoiding a motion to dismiss.

4. Beware of the possible conflict

There are times when the Respondent firm will hire an outside firm to represent a broker individually due to a potential conflict. In this situation, the brokerage firm will either retain two separate law firms (one for the broker and one for the firm) or hire outside counsel for the broker and continue to represent just the firm in-house. In either instance, this happenstance is certain to complicate the proceedings because each time there is a motion or objection, Respondents will have two sets of lawyers briefing and arguing the issues. This opportunity to "double team" can create havoc at pre-hearing conferences, allowing Respondents to get several bites at the apple.

Certain claims, such as those demonstrating that the broker intentionally concealed something material from their employer (e.g,. selling away or taking money from a client), or has acted in a criminal or quasi-criminal manner, may increase the odds that the broker will be represented by a separate attorney. Likewise, in cases of fraudulent activities such as theft from an account, forgery or outside business dealings, the Respondent firm may be required to argue that the fraud was perpetrated on it as well, placing the blame on the individual broker.

In these situations, the Claimant's attorney should attempt to allege as many facts as possible establishing the brokerage firm's knowledge of, and complicity in, the wrongdoing. For example, if firm letterhead was used for an outside business deal or if emails came in and out of the firm's offices relating to the fraud or misconduct, these would assist in proving joint liability and tend to show that "the shooter did not act alone." Facts evidencing the involvement or approval at the firm's management level may also assist Claimant's case, establishing any negligent supervision or *respondeat superior* claims against the brokerage firm itself.

Finally, if it appears from the broker's U-5 that there was a termination for cause, you should anticipate that the broker will be represented by separate counsel.[20] When you know that this is the case and you have enough ammunition against the firm, you should consider not naming the broker to avoid the multiple representation issue.

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20. *See* section II C., *infra.* for a discussion on investigating the broker.

B. The Regulators

Regulators of the securities industry include the SEC, FINRA and state securities departments. Any of these (or all three) may open investigations into your arbitration claim. Claimant's counsel should also be aware that certain facts could make it more likely that the regulators will get involved in your case. If your action involves any of the following,: (1) a broker with a checkered CRD (three or more customer claims); (2) a problem branch office; (3) serious allegations of theft or forgery; (4) selling away or outside business activities; (5) market manipulation or other fraud on the market theories; (6) elder abuse issues; (7) problem investments in the press; or, (8) firm wide supervision issues, it is possible that a regulatory inquiry may be instituted as a result of your claim.

The firm is required to amend the broker's U-4 or U-5 and report your claim whether it is formally filed as an arbitration or merely comes in as a letter of complaint. Once it is reported, regulators may become interested and open an investigation into the conduct of the broker and firm. They can be valuable to the extent that Claimant's counsel may be able to subpoena records and disciplinary action information from them. Public documents in SEC or FINRA enforcement actions may also help you add evidence of the bad acts alleged in your claim. Regulators may also provide you information "off the record" to assist in your case.

If a claim has resulted in regulatory action, a brokerage firm may be more likely to settle the matter in order to appear to the regulators that it has "done the right thing." This is particularly true in the case of a notorious investment or broker. In the "garden variety" claim, however, the brokerage firm may be just as likely to arbitrate the matter to prove to the regulators that the broker (and firm) did not act improperly. Accordingly, the experienced Claimant's attorney should carefully include all FINRA, SEC, state and federal securities violations clearly and concisely in the body of the claim if the action is one that may appear to lead to a regulatory investigation or action.

Attaching evidence of your client's allegations may also help in a quicker resolution of the claim. If the branch office is one that has had repeated violations, state this in the claim. Similarly, if the broker has a CRD that reads like a phone book, attach it to the Statement of Claim. If you perceive registration issues - such as failure to register the security in your state or the broker was not registered in your state when he or she sold the securities to your client -attach the relevant public documents.[21]

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21. Every state has its own set of securities laws—commonly referred to as "Blue Sky Laws"—that are designed to protect investors against fraudulent sales practices

If there has been an AWC between the broker or firm relating to the investment or conduct as issue, or if any other sanction has been issued by a Regulator, attach it to the claim as an exhibit. Finally, conduct research on the broker or investments to see if there exist any state investigations, actions or sanctions.

C. Broker-Dealer business people: "We make money the old-fashioned way...."

When drafting the claim, keep in mind that brokerage firms are in the business of generating revenue. At the end of the day, a settlement check is a business decision based on an evaluation of several factors as well as internal approvals. The resolution of your claim is driven by certain tangible and intangible business factors, including:

(1) a balancing of the defense costs verses likelihood of success of the claim;
(2) whether an important broker or manager has been implicated;
(3) value of confidentiality clause in settlement due to possible negative public relations;
(4) concern there may be other claimants with the same complaint;
(5) the identity of the named Claimant;
(6) the overall financial health of the brokerage firm;
(7) the availability of insurance coverage;
(8) to appease regulators; and,
(9) the firm's fiscal year versus the time of year of the settlement.

There are some firms which flat out refuse to settle claims above a certain threshold (such as 50% of out-of-pocket damages) simply because they want to establish the reputation of being a difficult target. Take the time to understand these business issues prior to trying to settle a claim pre-suit.

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and activities. While these laws do vary, most typically require companies making offerings of securities to register their offerings before they can be sold in a particular state, unless a specific state exemption is available. The laws also license brokerage firms, their brokers, and investment adviser representatives.

D. The Arbitrators

While you will not know who your arbitrators are until months after filing your claim, you do know that, in the typical customer case, you will have the option of an all public panel of three arbitrators or the choice to make one of your three arbitrators an industry representative.[22]

In smaller cases - those under $50,000 - the claims will be decided by one public arbitrator.[23] In cases between 50,000 to $100,000, the parties will have one public arbitrator unless they agree in writing to have three.[24] In any circumstance, you also can assume that, while you might have at least one attorney on the panel, other panel members may not be lawyers. You might have one person familiar with the brokerage industry, but sometimes there are none. Following these assumptions, you must draft your claim to explain clearly: (1) your client's investments and any operational issues to the non-industry arbitrators and (2) your legal issues to the non-lawyers. To the extent possible, define the issues in layman's terms.

In the investment and operational context, explain the nature of the securities or investment strategy. Then, if possible and appropriate, draw an analogy for the non-industry arbitrators. For example, in explaining varying levels of risk in options strategies you might include something like this: "Covered calls are like buying an insurance policy—they protect the investor in the event that the market moves in a particular direction. Naked options, on the other hand, are like putting your money on 'black' at a roulette wheel—it is an all or nothing proposition." Legal issues should, as well, be put in simple terms for the non-lawyers. For instance, rather than simply stating that the investments were unsuitable, spell out what constitutes "unsuitability" or "overconcentration" in the context of your claim. If your 90 year old client, living on social security, was invested 100% in the preferred shares of an e-commerce company, write this: "In order for the account to earn 5% a year rather than the CD rate of 2%, which Mrs. Garcia had at her credit union, the account was concentrated 100% in Flamazon preferred stock. When that company failed, she was left with nothing—and no way to generate future income. Had 100% of her funds not been put at risk in one stock, she would not have lost all of her retirement savings."

22. FINRA, Rules 12401, 12403 (2020).

23. FINRA, Rules 12401, 12402 (2020).

24. FINRA, Rule 12401 (2020).

Non- lawyers can easily understand this example of the legal claim, rather than just a label. This can go a long way in educating the non-lawyers as to what your client's claim is all about.

E. "Insure" a good result

Finally, the broker or brokerage firm may have insurance for particular claims. While the existence of insurance is often a closely guarded secret (even in cases where the insurer is paying part of a settlement), there are certain scenarios that are likely to bring an insurer into the picture.

There is often insurance coverage for the brokerage firm in cases of broker theft or forgery. So, if you have hard evidence of such misconduct, attach it to your Statement of Claim. Other policies may be written to cover the individual broker's conduct and generally contain clauses excluding intentional wrongdoing. For this reason, including a negligence count in your Statement of Claim – where the facts warrant such a claim - may be enough to bring your action within this type of insurance coverage.

Generally, until a claim is filed with FINRA, the duties of the insurer to defend and pay any arbitration Award will not be invoked.

IV. Anatomy of a Statement of Claim

Once you know what audiences you will be addressing in your claim, you are ready to begin drafting. It should contain six separate sections: (1) the case caption; (2) jurisdictional allegations; (3) introduction; (4) fact section; (5) legal claims; and, (6) damages. In order for the reader of the Statement of Claim to easily find a particular section it is good practice, if possible, to break up the sections into smaller sections divided by sub-headings. This also has the effect of making your claim easier to read and follow.

A. The Caption of the Case: What's In a Name?

Do not underestimate the significance of determining who will become Respondents in your arbitration. There are several schools of thought on this issue. Some believe that the scorched earth, name everybody in the zone of danger approach is best. There are times when this may be appropriate. For example, if you have a "serial broker" who has hopscotched from firm to firm leaving a trail of mass destruction in his or her wake, naming multiple firms can help. This may cause each of the brokerage firms to blame the other for the losses, causing infighting in front of the arbitrators and thus adding more credibility to your claims. A quick settlement with one Respondent early in the case may help fund the remainder of your client's case. And, if you must try your case against the other non-settling Respondents, the fact that another Respondent has chosen to settle should make it appear to the arbitrators that your claims have serious merit.

The downside to this strategy of naming as many Respondents as possible is that at all of your prehearing conferences there will be numerous Respondents' counsel, each of whom will get a chance to oppose any motions you make and further complicate the proceedings. Numerous Respondents will also be able to get more far- reaching financial and investment history on your client as the relevant time-frame gets broadened with each additional brokerage firm Respondent. The further back you allege misconduct, the further back Respondents will try to obtain discovery into your client's finances.[25] Make sure you evaluate the client's investment behavior in the earlier years when determining how far back you want to allege the claims. Another factor you might want to consider when there are multiple firms involved is whether you will be able to allege an ongoing fraud to defeat any eligibility arguments the earlier brokers may raise.

There are also times when you will consider naming fewer than all responsible parties. It is becoming more common for customer attorneys to forego suing the individual brokers for several reasons.

- First, particularly in the case of an egregious wrong or simply an unlikeable broker, there is the chance that the arbitration panel may choose to allocate losses between the parties, rather than enter a joint and several award. You want to avoid the situation where the panel allocates 90% of the Award to the broker and only 10% to the firm. Your client may never get a recovery in this situation. Therefore, if you are certain that your *respondeat superior* and/or failure to supervise claims are airtight, consider not naming the broker if you fear the looming fault allocation and collectability issue.
- In a product failure case, it is best to forego naming the individual broker who probably had no idea that the investment he or she was told to peddle was in fact risky or inherently unsuitable from the inception.

25. FINRA Code of Arbitration Procedure Rule 12506 sets forth certain presumptively discoverable documents which should be exchanged by the parties. With respect to the Claimant, these include financial information and tax returns for the "3 years prior to the conduct at issue in the statement of claim." FINRA, Rule 12506 (2020).

- Not naming the individual broker may also make the broker more likely to cooperate with you or be a more friendly witness. While the broker will still want to prove his or her innocence (because the firm will still have to report the claim on the broker's U-4 or U-5),[26] as a witness the broker may be less hostile if you are not after his or her personal funds. That said, the firm can still seek contribution from the broker for any sums it is required to pay your client if there was actual broker wrongdoing.

Naming the individual broker may have benefits. If, for instance, the broker is a big producer and important to the firm, it may have some incentive to settle the action in order to seek expungement in connection with the settlement.[27] You should name the broker as a Respondent only if the broker actually committed the wrongdoing. In the situation where the broker has simply sold a defective product, or the firm has problematic clearing or back office procedures, you should only name the firm.

If the Claimant has named a broker as a Respondent who is not the real party at fault, this may engender sympathy from the panel when the broker takes the stand and may not assist your case, unless the broker points the finger at his or her current employer (which is unlikely if the firm is providing the broker with a defense attorney). Similarly, the branch manager or other control persons should be named only where there is evidence that they actively participated in the wrongful conduct through some deliberate or grossly negligent means.

B. Jurisdiction and Venue: What Are You Doing Here?

FINRA's jurisdiction, as well as the jurisdiction of any particular self-regulatory organization ("SRO"), such as the National Futures Association ("NFA") or Commodities Board Options Exchange ("CBOE"), is a creature of contract or of the SRO's own mandate. To determine where jurisdiction is

26. *See supra* note 3.

27. Expungement is a FINRA proscribed mechanism to remove a customer complaint from the broker's CRD record. In order to do so, under FINRA Rule 2080, the arbitrators must determine one of three things: 1) The claim, allegation, or information is factually impossible or clearly erroneous; 2) the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds; or 3) the claim, allegation, or information is false. FINRA, Rule 2080 (2020).

proper, ask your client for his or her arbitration provision (contained in the new account forms or margin agreement). That provision will set forth the arbitration forums that are available to your client.

If your client held a securities account at a FINRA member firm, FINRA will likely be the specified forum. If there is no arbitration contract, your client is still given the right to bring an arbitration by virtue of the Respondent firm's membership in FINRA.[28]. FINRA similarly has jurisdiction over the individual broker because the broker is "associated with a member organization."[29]

Allege the jurisdictional basis at the beginning of your Statement of Claim. FINRA has jurisdiction only if the "dispute arises in connection with the business activities of the member or the associated person."[30] There is an exception against "disputes involving the insurance business activities of a member that is also an insurance company."[31]

Be sure to include your choice of venue. FINRA provides 70 arbitration hearing locations in each of the 50 states, Puerto Rico and London.[32] Unless you specify a choice of venue (and sometimes even if you do specify a choice), FINRA will assign your arbitration to the venue where the client resided at the time the account was open.

You may wish to request a different venue if your client has since moved or if your client has multiple residences or simply if you wish to choose what you believe to be a more Claimant-oriented venue that has some ties to the dispute at issue. For example, if the broker's office was located in Florida, but the client resided in Washington, D.C. (a venue that some practitioners believe has a large pool of conservative defense-oriented arbitrators), you might wish to allege that venue is proper in Florida for a host of reasons, including that Florida law governs (allowing attorney's fees for securities violations) and that most of the defense witnesses reside there.

28. *See* FINRA, Rule 12200 (2020).

29. *See Id.*

30. *Id.*

31. *Id.*

32. https://www.finra.org/arbitration-mediation/finra-hearing-locations.

C. The Narrative Part of Your Statement of claim: Just the Facts Ma'am

The beauty of arbitration is that it is a fact-driven process, as opposed to one that is based substantially on the law. In many arbitrations, the majority of your arbitration panel will not be attorneys. As such, the audience of your claim will give greater focus to the fact section of your claim than they will to the legal section.

This is not to say that the law is unimportant to your claim, but drafting pages and pages of legal jargon setting forth the legal bases of your claims is simply not warranted or even required in an arbitration.

Draft the claims in a narrative fashion and make the facts both interesting and easy to read. Many subheadings breaking apart the different sections of your narrative can help the reader get through it and later go back to any particular section.

The facts should address the who, what, when, how, how much, and in which compensable way.

1. Introduction

It's always a good idea to have a snappy introduction to set the tone of your claim. Although this section will come at the beginning of your Statement of Claim, write this section after you have completed the entire pleading so you know where your emphasis should be.

Personalize your clients and try to make them the sympathetic victims of the securities wrongdoing for which they are seeking recovery. Summarize your case in one to three short and punchy paragraphs and explain what happened in a simple summary fashion.

An example of a brief Introduction would be something like this: "Manny Jones is the hometown hero of the Springfield, Illinois Springboks baseball team. He went straight to the minor leagues from Springfield High School and soon became an All Star short stop. He hit the winning run for the Springboks when they clenched the World Series in 1962. His chain of fast food restaurants - 'Jones' Wingbones' - employs 50% of Springfield residents. His stockbroker and former son-in-law, Dwight Dumfy, recommended that Manny cash in his low returning CDs and use the proceeds to invest in a risky options strategy in his account at Springbok Securities. In just three short months, Respondent lost the entirety of Manny's life savings. Manny had to sell his World Series ring in order to pay for his kidney transplant." This paragraph alone should let the readers know what result is compelled in this case. Enough said.

2. Background of the Claimants

Next, begin with a chronological narrative explaining in detail who the Claimants are, detailing their background and highlighting things about them to both make them sympathetic as well as credible.

Who the Claimants are is one of the most important parts of your case. Begin with personal things such as your client's age, how long the client has been married (if married) and how many children and grandkids were raised (if any). If the Claimants were in the military or participated in charity work, add these facts. If others, such as elderly parents, rely on their financial support, mention this fact. If your client has a college degree, but was always a full-time homemaker, be sure to include this. Also, if the client suffered from any mental or physical defects that would have been apparent to the broker, this is relevant to the investment decisions made contemporaneously.

Explain where the money invested came from and, if compelling, how it was earned. If it represents retirement savings from years in the workforce, detail this. This is also the place to explain how the Claimants met the broker, their investment history and how they ended up opening their account.

If you happen to represent a wealthy client, make sure, if applicable, to emphasize their inexperience in the market or in the type of investment at issue. When the client is a widow, and previously relied on her spouse to make investment decisions, this too is an important fact to include.

This is the only chance your arbitrators have to evaluate your client prior to the hearings, so use this section to vividly paint the portrait of your client and set the tone for the case.

3. What Was Purchased? Investing 101

The claim should clearly identify and explain the investments or strategy at issue. Because two and possibly three arbitrators are not "industry" people, you should identify the investments at issue and explain the nature of the investments involved. Even with the most common investments - such as stocks and mutual funds - it is helpful if the arbitrators can be educated.

An experienced Claimant's attorney will identify the particular investment vehicle and explain its characteristics. This is even more important in the case of a complex investment or strategy. Many cases today involve new and creative vehicles. You should identify the investment along with an explanation of how it works and what the investment terms mean. Thus, rather than just alleging "Respondents sold Claimant Exchange Traded Notes," you can add "Respondents represented to Claimant that J.P. Brogan Energy Index

Exchange Traded Notes were a 'guaranteed' investment, never disclosing the risk that if J.P. Brogan - the issuer - collapsed, so did its guarantee. Exchange Traded Notes are dependent on the credit quality of the issuer. As an underwriter of the offering, Respondent knew these risks, but failed to disclose them."

With respect to more exotic investments, explaining their nature and dangers can go a long way in making your case. Investments such as exchange traded products, unit investment trusts, real estate investment trusts (REITs) and private placements should be clearly explained in a separate section.

Similarly, particular investment strategies such as the use of credit facilities of affiliated banks, hedging, options strategies, short selling, collars, dollar cost averaging and the use of margin should be explained for the non-industry arbitrators. The characteristics may be set out in a separate section entitled "A Primer" on whichever investment or strategy you are explaining, including definitions and explanations of risks and dangers from reputable financial publications. Consider attaching articles and giving the url address for internet sources.

4. What was Represented and What Did Respondents Receive?

The Statement of Claim should detail the facts surrounding the sale of the offending product. You should also be clear about the representations were made and by whom they were made. Articulate both the broker and the firm's involvement in the transactions at issue. There are certain investments for which FINRA and SEC have issued sales guidelines and/or a Notice to Members ("NTM")[33] providing guidance to brokers and firms. Structured products, leveraged exchange traded funds, inverse exchange traded funds, variable annuities, bond and bond funds and mutual funds fall into these guidelines.

33. When FINRA was created, Notices to Members ("NTMs") were renamed Regulatory Notices ("RNs"). Anything prior to July 2007 is an NTM, anything after is referred to as an "RN".

Check the FINRA Regulatory Notices for the particular investments at issue to ascertain whether there have been sales guidelines articulated by regulators. Importantly, investment strategies as well as investments can be the subject of a claim. FINRA has made clear that brokers must ensure that investment strategies, as well as the securities themselves, are suitable for investors.[34]

Just like a jury is called upon to judge the credibility of witnesses, arbitrators must evaluate the truthfulness of your client and the broker. Establishing a motive can go a long way in setting forth and proving a credible claim. The arbitrators will all want to know: What compensation did the Respondents receive?

A prepared Claimant's attorney will have a profit and loss evaluation done, including a commission and cost analysis (if warranted), prior to filing the arbitration and will be able to state with reasonable certainty the remuneration paid to the Respondents, at least to the degree that compensation has been disclosed through confirmations, prospectuses or other offering documents.

One effective strategy is to set out the commissions, fees and costs as compared to the total investment return to the client or as compared to the average equity in the account. The comparison can be compelling, for example, where you can state: "Claimant lost $250,000 in the account while the Respondents received approximately $250,000 in commissions, fees and margin interest" or "the cost of the investment strategy to Claimant was 25% of the average equity in the account, meaning that Claimant's account had to earn 25% just to break even."

Annuities and life insurance products often contain staggering sales charges and should always be reviewed prior to filing the claim. Although commissions are part of the equation, other sales charges such as management fees or wrap fees can sometimes be charged in addition to the commission.

Other fee-generating situations should be highlighted. Review the prospectus or other offering document to see what fees were charged and what other ways the Respondent received money from the investment. Underwriters or placement agents can make fees on sales of new issues.

Where it appears that there was no investment purpose other than to generate commissions - such as mutual fund switching among similar funds- spell this out. Finally, if the investment is a proprietary one created and sold by the firm, explain that fact. If the firm or its affiliates received compensation for managing an investment, this is also relevant.

34. *See* FINRA RN 11-02, 2011 (Jan. 10, 2011).

In sum, allegations establishing financial motive can greatly enhance your claim.

5. How Could it Have Been Prevented or Detected?

You are drafting a claim to recover money from the brokerage firm, which is generally the "deep pocket" in the case. Although the broker is often the primary wrong-doer, the firm is liable for his or her acts under two different legal principles: (1) under *respondeat superior*, the brokerage firm, as the principal, is liable for the acts of the broker, acting as its agent and (2) the brokerage firm can be liable for negligent supervision, negligent hiring or negligent retention of the broker.

With respect to principal/agent issues, allege facts showing that the broker was acting within the scope of his or her employment. Any actions by the broker in connection with providing investment advice or in connection with the purchase or sale of any investment should meet this criteria.

FINRA has set forth procedures for the vetting and supervision of complex investments, which may include a security with novel, complicated or intricate derivative-like features, such as structured notes, inverse or leveraged exchange-traded funds, hedge funds and securitized products, such as asset-backed securities.[35] There are also other FINRA NTMs regarding specific investments such as bonds and bond funds,[36] hedge funds[37] and variable annuities.[38] Due to the number of new investments being introduced, FINRA instituted a catch-all NTM on all new products, setting forth procedures which firms must follow in approving them for sale to customers.[39] To the degree that such supervisory procedures were violated or ignored, these may serve as the basis for a failure to supervise claim.

With regard to negligent supervision, you should set forth facts demonstrating both the lack of management's communication with the client and the apparent failure to monitor the accounts at issue. Where there is a particularly active account or an account with large losses, overconcentration in a particular security or sector, or large margin or loan positions, the claim

35. FINRA RN 12-03, 2012 (Jan. 17, 2012).

36. FINRA NTM 04-30, 2004 (Apr. 13, 2004).

37. FINRA NTM 03-07, 2003 (Jan. 23, 2003).

38. FINRA NTM 99-35, 1999 (May 1, 1999).

39. FINRA NTM 05-26, 2005 (Apr. 6, 2005).

should explain how the lack of oversight allowed the conduct of the broker. The claim should state clearly in what ways the firm is at fault and how the misconduct could have been prevented or detected earlier.

Similarly, the failure to monitor a broker who has ongoing personal issues which may impact his or her judgment or conduct, may also be a basis for supervisory claims. For instance, a broker with substance abuse problems or one who has financial problems such as a bankruptcy or divorce-related economic pressures, should be carefully supervised. Setting forth how the firm should have seen such "red flags" but failed to monitor the broker or accounts properly will help support a claim of failure to supervise.

D. Your Legal Section: I Fought the Law and the Law Won

A brief minute on legal claims. Because FINRA arbitrations are fact driven, there are several schools of thought on how much of the law should be included in a Statement of Claim. A Claimant's attorney should be able to explain how a statute, common law principle or regulation was violated by Respondent's actions.

Since many FINRA arbitrators are not attorneys, this should be done in an easy-to-read and concise fashion. The claims should be identified and the basic elements set forth so that the arbitrators can see how your facts fit into the legal theories of your case.

Typical claims in a securities arbitration are: federal securities law violations; state securities law violations; breach of fiduciary duty; negligence (predicated on violations of FINRA or SEC regulations); common law fraud; breach of contract, *respondeat superior;* negligent supervision and negligent hiring. Some states have elder abuse laws which may also come into play and which often allow for attorneys' fees.

State securities statutes vary, but most are modeled on the federal law, Section 10(b) of the Securities Exchange Act of 1934.[40] Some states, like Florida, have less stringent standards and do not require the Exchange Act's "intent or scienter" element. Other state securities statutes are desirable since they provide for the awarding of attorney's fees to a successful plaintiff.

You should also carefully review your state's securities law statute to determine if it has a "fee-shifting" provision, which provides attorney's fees to the prevailing party and, if so, carefully explain to your client the risks associated with including such a claim in your pleadings.

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40. 15 U.S.C. §78j (2020) (the "Exchange Act").

Respondeat superior, negligent hiring and negligent supervision are important to the outcome of your case because they impose liability on the brokerage firm. The doctrine *of respondeat superior* confers liability on a corporation for the acts of its agents committed while acting in the scope of their employment. Make certain to include these claims, where applicable, when you are bringing an arbitration against a brokerage firm.

E. Damages: When to say "When"

Finally, the claim must notify the firm, FINRA and the arbitrators what your client is seeking to recover and the recognized claims for recovery. This is important for several reasons.

- First, the damages portion of your claim determines the amount of the FINRA filing fees your client will be required to pay. FINRA's website includes a link to a filing fee calculator to prevent the miscalculation and consequential delay as a result of sending the statement of claim with the incorrect filing fees.[41]
- The damages section of your Statement of Claim also notifies the brokerage firm and the regulators how significant the case is in terms of the potential financial exposure. The brokerage firm is required to state how much your claim seeks when reporting it to FINRA and the amount sought will ultimately appear on the broker's U-4 or U-5.
- Publicly-traded brokerage firms usually set up a reserve to pay claims made against it in the event that the firm settles or is required to pay an arbitration Award or court judgment.

41. http://apps.finra.org/ArbitrationMediation/ArbFeeCalc/1/Default.aspx.

- The amount of damages at issue dictates whether your claim qualifies for simplified arbitration, which allows for a single arbitrator in cases under $50,000 with the option to have the case decided on the papers (almost never recommended) rather that at an in person final hearing.[42] There are a number of factors to consider when determining whether to proceed on the papers alone and it is a decision that should be discussed extensively with your client. If your claim is between $50,000 and $100,000, you are entitled to have your case decided by one arbitrator unless the parties stipulate to three.[43]

The damages section should state your client's different theories of damages such as, but not limited to:

- "compensatory damages," which are meant to compensate the claimant for he wrongdoing;
- "benefit of the bargain damages," which are meant to place the claimant in the position represented to him or her when the investment was sold; or,
- "well-managed account damages," which awards claimant the amount the account should have returned had it been properly managed.[44]
- There are other compensable damages such as disgorgement of commissions or rescission.[45]

Your claim should also address exemplary or punitive damages and the basis for such a damage claim. You should set forth your clients' claims for pre- and post-judgment interest, but without specifying any statutory rate, since this can be done at the final hearing and may change during the course of the case.

Finally, any claims for attorney's fees and costs - and the basis for these claims - should be spelled out in the Statement of Claim. In Florida and other jurisdictions, the parties must both agree that the arbitrators have the authority to both assess the entitlement to and amount of an attorney's fee Award.[46] To

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42. FINRA Code of Arbitration Procedure 12800, Simplified Arbitration allows for three types of resolution: a) On the papers, b) an abbreviated telephonic hearing with limited testimony, and c) a full final hearing. FINRA, Rule 12800 (2020).

43. FINRA, Rule 10202 (2020).

44. https://www.finra.org/sites/default/files/arbitrators-ref-guide.pdf at 66-67.

45. *Id.*

46. *Turnberry Assocs. v. Serv. Station*, 651 So. 2d 1173 (Fla. 1995), sided with the Third and Fourth districts and firmly established the principle that parties may stipulate to waive their right to have the circuit court determine entitlement to

the extent that you do not want the arbitrators to assess the amount of attorney's fees, but only your client's entitlement to them (the amount to be later determined by a court), you may wish to specify this request in the claim so that there is no argument that your request for a fee Award waived this right to proceed to court on the assessment of fees.

A well-articulated damage portion of your claim alerts the firm (and the regulators) to the potential exposure that your case could engender. This is not to say that you should make unrealistic damage claims. Overinflated damage claims may backfire when you are in front of arbitrators with respect to your client's credibility. Outlandish claims can also turn off in-house and defense lawyers, causing them to believe that the case can never settle at a reasonable number. While you should be a zealous advocate for your client your claim for damages will often be a starting point in settlement negotiations and defense counsel expects that your demand will go down from the number initially alleged. Taking these facts into consideration, the seasoned Claimant's counsel knows when to say "when," or, to put it another way, how to ask for damages that reasonably fall within the parameters of accepted legal theory without going overboard.

F. Tidying Up: Numbering, Exhibits and Personal Information

In accordance with the guidance of the FINRA *Arbitration Filing Guide*,[47] you should number the pages of your claim to include the total number of pages. If, for example, your Statement of Claim is 20 pages, the first page should be numbered "Page 1 of 20". If your Statement of Claim refers to documents, copies of the documents should be attached as exhibits. Exhibits must be clearly identified and a complete set should be attached to the Statement of Claim. Importantly, confidential information in those exhibits should be redacted. [48] Where such data must be referenced, use only the last

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attorneys' fees and confer subject matter jurisdiction upon the arbitrators to award fees.

47. https://www.finra.org/sites/default/files/arbitration-claim-filing-guide.pdf.

48. FINRA Rule 12300(d)(1) requires that personal confidential information be redacted from any document filed on the portal. FINRA, Rule 12300(d)(1) (2020).

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CONCLUSION

Choosing the right cases to accept is paramount to your practice and an investor's life. Taking the time to know your client and your client's case before drafting the Statement of Claim will go a long way in paving the road for a positive resolution. And, while there is no tried-and-true formula to drafting a securities arbitration Statement of Claim, making it interesting to the readers and setting it out in an easy-to-understand fashion for non-lawyers and non-industry personnel can be quite effective.

The Statement of Claim is often the first look any decision-maker has of your client's case and preparing a well-drafted and supported pleading may place your client in an excellent position to resolve claims prior to a full hearing. While brokerage firms often say that nobody has a crystal ball to predict markets, you may be able to help predict the outcome of your client's case through effective use of your most powerful weapon: your keyboard.

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counsel to PaineWebber Inc. (now known as UBS Financial). For more information, go to: www.investorfraudlaw.com. As a final note, the author wishes to thank her editor extraordinaire, David Robbins, who greatly enhanced both the original and new versions of this article with his thoughtful and practical comments.

FINRA ARBITRATION IN AN ONLINE WORLD: ETHICAL AND PRACTICAL

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COVID-19 has had a significant impact on all aspects of our lives. FINRA Dispute Resolution Services took an unprecedented step as the world began to stay at home: postponing all in-person arbitration and mediation proceedings.[1] But, just because lawyers are working from home, or in a limited, socially-distant capacity in the office, does not mean that arbitration and mediation should, or can, wait. For example, FINRA has offered an expedited hearing option for senior or serious ill parties since 2004,[2] and has shortened the turnaround time from filing to award by 10% from 2019 to 2020, averaging 15.5 months for regular decisions, 6.7 months for special telephonic proceedings, and 5.3 months for paper proceedings.[3] Expedited hearings serve an important goal: ensuring that claimants who have a serious health concern are able to obtain a result as soon as possible.[4] And, in a world where health concerns are front page news and Americans are suffering extreme financial difficulties, concluding a FINRA proceeding expeditiously is extremely

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1. FINRA, *Coronavirus Impact on Arbitration & OHO Hearings*, available at https://www.finra.org/rules-guidance/key-topics/covid-19/hearings (last accessed July 22, 2020).

2. FINRA, *Expedited Proceedings for Senior or Seriously Ill Parties*, available at https://www.finra.org/arbitration-mediation/expedited-proceedings-senior-or-seriously-ill-parties (last accessed May 29, 2020) ("upon request, staff will expedite the administration of arbitration proceedings in matters involving senior or seriously ill parties").

3. FINRA, *Dispute Resolution Statistics*, available at https://www.finra.org/arbitration-mediation/dispute-resolution-statistics (last accessed May 29, 2020).

4. *Id*. (when counsel advises of need for expedited proceeding "the arbitration panel is expected to press for hearing dates and discovery deadlines that will expedite the process yet still provide a fair amount of time for case preparation").

important. At the same time, however, the realities of proceeding in the typical fashion must be revisited. With most lawyers now working from home, they may have responsibilities for childcare and schooling, may be taking care of family members with illnesses, or may either be ill themselves or a member of a high-risk group.[5] Clients face similar challenges, which may be magnified if they are not technologically literate.

Balancing the interests of parties to promptly conclude their proceedings with the new realities of working from home (or the risks presented by leaving home) has become extremely important. FINRA's decision to postpone all hearings automatically was counterbalanced with an opportunity: if the parties agreed, FINRA would permit hearings and mediation proceedings to go forward on an online Zoom platform and has issued guidance on how such hearings will proceed.[6] This new option to proceed virtually rather than in-person nevertheless has its challenges and raises significant questions for lawyers and clients to resolve together. Is proceeding virtually in the best interest of the client? Does it help clients best achieve their goals? What should lawyers and clients consider when working together to make that decision? If lawyer and client jointly agree that proceeding virtually is in the client's best interest, what ethical concerns might arise?

This short article considers the practical and ethical concerns of participating in a virtual FINRA arbitration proceeding. We begin by outlining the initial guidance FINRA provided for hearing postponements and options for proceeding virtually. We then turn to ethical concerns that arise in the client-attorney relationship followed by ethical issues that may arise in a virtual hearing. While the rapidly evolving situation and parties' experiences in remote FINRA arbitration proceedings inevitably will provide additional guidance and recommendations before this article is printed, the underlying practical and ethical considerations will remain relevant to discussions between lawyers and their clients about whether to proceed and, if they decide to do so, how to ensure that the client is protected.

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5. For example, 72% of arbitrators on FINRA's arbitration roster are 61 years of age or older. *See* FINRA, *Our Commitment to Achieving Arbitrator and Mediator Diversity at FINRA*, available at https://www.finra.org/arbitration-mediation/our-commitment-achieving-arbitrator-and-mediator-diversity-finra (last accessed May 29, 2020).

6. FINRA, *FINRA Dispute Resolution Services Arbitrator Resource Guide for Virtual Hearings*, available at https://www.finra.org/sites/default/files/2020-06/FINRA-Dispute-Resolution-Services-Arbitrator-Resource-Guide-for-Virtual-Hearings.pdf (last accessed June 22, 2020).

I. INITIAL FINRA GUIDANCE FOR HEARINGS POST-COVID 19

As of the date this article was submitted for publication, FINRA released guidance for proceeding virtually but has not yet released guidance on whether in-person proceedings may restart and, if they do, how they might look. At the very least, FINRA will be considering not only when states and municipalities permit reopening, but also how to maintain sufficient separation to protect participants from the virus and ensuring that all participants, many of whom may be more vulnerable to COVID-19, will feel comfortable proceeding. Until then, FINRA has administratively "postpone[d] all in-person arbitration and mediation proceedings schedules through October 2, 2020."[7] Since the pandemic is expected to last for the foreseeable future, FINRA has also waived postponement fees for hearings between October 5 through the end of 2020 if the parties agree.[8] A written notice of the stipulated postponement must be received more than 20 days prior to the hearing date or postponement fees may still apply.[9]

Nevertheless, arbitration and mediation proceedings may proceed, so long as they take place over the telephone or via the technological platform Zoom and either the parties stipulate to go forward, or the panel orders that the case proceed.[10] Opposing parties appear to have differences of opinion as to whether an arbitration proceeding should go forward, as evidenced by the increasing number of contested motions to use Zoom for a hearing that was scheduled pre-COVID 19. As of June 2, 2020, FINRA reported that parties had filed 28 motions relating to using Zoom for FINRA arbitration proceedings.[11] Eighteen of those motions were filed in customer cases, with six being granted and two being denied; another ten are pending.[12] FINRA has since released guidelines for how Zoom hearings will be conducted.[13] The guide, geared towards arbitrators, outlines technological concerns and focuses

7. FINRA, *Coronavirus Impact on Arbitration & OHO Hearings*, *supra* note 1.

8. *Id*.

9. *Id*.

10. *Id*.

11. Townhall with FINRA Leadership, PIABA Webinar, Discussion by Richard Berry (June 2, 2020).

12. *Id*.

13. FINRA, *FINRA Dispute Resolution Services Arbitrator Resource Guide for Virtual Hearings*, supra note 6.

on the foundational principle of FINRA proceedings: that they must be conducted fairly and impartially.[14] Though FINRA's guide comprehensively answers many practical and technological questions, Dispute Resolution Services will automatically train neutrals and conduct trial runs prior to proceedings commencing.[15] Upon request, FINRA will also offer opportunities for trial runs to the parties.[16]

II. ETHICAL CONSIDERATIONS IN REMOTE HEARINGS AND MEDIATION

FINRA's release of Zoom hearing guidelines provides parties a better sense of what an online hearing will look like and will inevitably result in more parties and arbitrators considering the use of the medium. The guidelines answer many practical questions, though some considerations cannot be answered by FINRA upfront. Lawyers engaged in remote hearings in other practice areas have articulated many of those anxieties: "Will my internet work? Will my electricity stay on? Will my neighbor decide to mow their lawn right outside my window?"[17] In addition to these concerns, FINRA practitioners should remain mindful of their ethical responsibilities to their clients. From the client-lawyer dynamics in determining whether and how to proceed to the events during the hearing itself, ethical considerations abound when online hearings are involved. We start with a review of the ethics rules that pertain to the lawyers' responsibilities to the client and proceed to the ethical considerations that arise at the virtual hearing stage.

A. Postponing or Proceeding? Client-Lawyer Ethical Considerations

While the technology of remote hearings may be new to many lawyers, their clients, and arbitration panels, virtual hearings present opportunities that

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14. *Id*. at 2 (describing fairness and impartiality required for FINRA arbitration and when those principles may be at issue).

15. *Id.* at 3.

16. *Id*.

17. Michael A. Mora, '*Quiet. Mom's in Court': Akerman Miami Partner Describes Taking Part in Historic High Court Virtual Hearing* (May 19, 2020, at 1:47 PM), https://www.law.com/dailybusinessreview/2020/05/19/quiet-moms-in-court-akerman-miami-partner-describes-taking-part-in-historic-high-court-virtual-hearing/#.

lawyers might embrace when not in a pandemic – the ability to make witnesses and parties available when health or other concerns makes their physical appearance impractical. Technology does not come without concerns, however. Historically, lawyers have been among the last adopters of technology that all now take for granted – including the telephone – because of ethical concerns.[18] The American Bar Association (ABA) recently reviewed its Model Rules of Professional Conduct to determine if and how the model rules that most jurisdictions use as the basis for their own ethical requirements should be revised to take into account concerns raised by technological advances. As part of this Ethics 20/20 review of the Model Rules of Professional Conduct, the ABA made several changes to reflect the changes in how lawyers do and should work with clients in today's world.[19] Most of those changes have to do with the substantial impact of technology upon the practice of law, with little change to the underlying responsibilities that lawyers owe to their clients, recognizing that the technology changes so quickly that specific platforms could not be incorporated into the Model Rules.[20]

1. Competent Representation Requires Technological Knowledge

As an initial matter, the ABA made clear that for lawyers to adhere to the duty "to provide competent representation to a client,"[21] they must "keep abreast of changes in the law and its practice, including the benefits and risks associated with relevant technology."[22] Thirty-eight states have so far adopted

18. Catherine J. Lanctot, *Becoming a Competent 21st Century Legal Ethics Professor: Everything You Always Wanted to Know About Technology (But Were Afraid to Ask)*, 2015 Prof. Law. 75, 76 (2015).

19. American Bar Association, *ABA Commission on Ethics 20/20,* available at https://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20120508_ethics_20_20_final_hod_introdution_and_overview_report.pdf.

20. Agnieszka McPeak, *Social Media Snooping and Its Ethical Bounds*, 46 Ariz. St. L.J. 845, 858 (2014) ("it may be that no precise framework of legal ethics rules can effectively address specific scenarios surrounding new technology like social media, as technological advances move more quickly than any rule-making process.").

21. Model Rules of Prof'l Conduct r. 1.1 (Am. Bar Ass'n 2020).

22. *Id.* at cmt. [8].

some form of duty of technological competence,[23] though the states that have not adopted the specific rule change may believe that it is already encompassed within the prior version of the rule.[24] Competence requires an understanding of the technologies that may be used in the representation of a lawyer's client. Thus, lawyers who specialize in FINRA proceedings must become familiar with the only means through which a client's case may go forward in mid-2020 – virtually via the Zoom platform.[25] Moreover, technical competence includes the ability to ensure security of client information and communications. FINRA has issued an information notice to assist in ensuring sufficient cybersecurity measures are undertaken, warning against common cyber threats and providing commonsense advice for preventing attacks.[26] After taking time to understand the platform and how to properly and securely use it, lawyers should consider how aspects of a hearing that are typically undertaken in person will operate in a virtual format. Only after this analysis is undertaken can a lawyer weigh the risks and advise a client as to whether or not the case should proceed.

2. Leveraging the Duty of Communication to Benefit Clients

Clients and their lawyers always make tough decisions. These decisions are more difficult in a world where COVID-19 provides only virtual options for hearings. Among the bedrock ethical responsibilities owed from lawyer to

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23. Robert Ambrogi, *Tech Competence*, available at https://www.lawsitesblog.com/tech-competence (last accessed May 29, 2020).

24. Nicole G. Iannarone, *What Every Attorney Should Know About Technology in Practice*, 26 PIABA B.J. 59, 62 (2019) ("Lawyers in states that have not yet adopted Comment 8 concerning technological competence are not exempt from the duty. The drafters of the change noted that the comment merely provides additional information explaining the parameters of a duty already part of the competence rule. Thus, all lawyers should assume that technological competence is one of the duties they owe their clients as part of the broader duty of competence.").

25. FINRA, *Coronavirus Impact on Arbitration & OHO Hearings*, *supra* note 1.

26. FINRA, *Cybersecurity Alert: Measure to Consider as Firms Respond to the Coronavirus Pandemic (COVID-19)* (Mar. 26, 2020). For example, public wi-fi networks should be avoided when accessing client information to prevent unauthorized third-party access. The use of anti-virus and anti-malware software should be installed and used on all devices as well as ensuring devices are locked whenever not in use, even if it is only for a quick break.

client is the duty of communication. A lawyer is required to keep a client "reasonably informed" and to "consult with the client about the means by which the client's objectives are to be accomplished."[27] "Clients normally defer to the special knowledge and skill of their lawyer with respect to the means to be used to accomplish their objectives, particularly with respect to technical, legal, and tactical matters,"[28] and a client may be more inclined to do so given the disruption of COVID-19 on their FINRA proceeding. While hearings through early September 2020 have been postponed, the opportunity to proceed virtually means that clients will likely call on their lawyers to help make a decision about what is best for the client's case. Even if the client does not seek such counsel, the lawyer should proactively begin a conversation about the best course for the client's proceeding.

As part of this discussion, client and lawyer should carefully talk through a number of considerations. In which forum will the client's story be best told? Is the client most comfortable proceeding in person or virtually? How comfortable is the client with technology? If the client is not currently technologically literate, is the client willing to learn? Is there a reason like age or other infirmity of the client or a witness that necessitates a prompt hearing? Is the client financially able to wait until in person proceedings recommence or are they in need of a final decision as soon as possible? If the client is inclined to wait for an in-person hearing, how long is the client prepared to wait? Will the client be comfortable proceeding if social distancing measures are in place, or will the client prefer waiting until the pandemic concludes? What is the most important concern for the client? Though a lawyer may not guarantee that the case will proceed virtually without the opposing party's agreement or an arbitrator's ruling, working through these and similar questions will help the lawyer satisfy the communication duty while also developing the best strategy for achieving the client's goals.

3. Protecting Client Confidential Information in Virtual Practice

While engaging in this communication, lawyers should ensure that the conversations between client and lawyer, and all other conversations, remain confidential. Lawyers are ethically required to keep confidential all information they gain as a result of the client-lawyer relationship: "A lawyer

27. American Bar Association, *supra* note 21, at r. 1.4.

28. *Id.* at r. 1.2 cmt. [2].

shall not reveal information relating to the representation of a client."[29] There is a technological overlay to the confidentiality obligation: lawyers are required to take "reasonable efforts" to ensure that client confidential information is protected from both unauthorized access and unauthorized disclosure.[30] Accordingly, if a lawyer is having a conversation with a client about whether and how their FINRA case will proceed, the lawyer must ensure that the technology facilitating the communication is secure. A lawyer is also required to take steps to ensure that strangers to the client-attorney relationship do not receive confidential information. Both client and lawyer should therefore ensure that family members do not enter the rooms where their conversations are taking place. Using a headset may minimize the chance for audio being overheard outside the door.[31] Lawyers should also evaluate the security of their devices and act reasonably to prevent access to devices that contain client information by members of the household[32] as well as any other intruders, including by using passwords, employing two-factor authentication, and ensuring that security settings and software are up to date.[33]

As they contemplate whether a virtual hearing makes sense for this particular client, lawyers should also explore how they will ensure that they

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29. *Id.* at r. 1.6.

30. *Id*.

31. For example, lawyers have taken to putting signs on office doors to remind family members that they should not interrupt or eavesdrop during important meetings. *See* Mora, *supra* note 17 (lawyer arguing in first U.S. Supreme Court virtual arguments taped sign reading "Quiet, Mom's in Court" on door to prevent being interrupted). Absent such measures, client-lawyer conversations can be quickly interrupted. *See, e.g.*, Steven Morris, *South Korea expert interrupted by children on BBC World News goes viral*, The Guardian (Mar 11, 2017, 7:49), https://www.theguardian.com/media/2017/mar/10/south-korea-expert-interrupted-baby-toddler-live-tv-viral#maincontent (recounting story of father's children running into room while he was being interviewed by BBC).

32. For example, this is a lesson that current law student Kim Kardashian learned quite well after her 2-year-old daughter North inadvertently posted a photo to Kim's Instagram page while playing with her phone. Joyce Chen*, Kim Kardashian Explains How North West Posted That Bikini Photo of Her: "I Swear North Posted This* (Nov. 25, 2015), https://www.usmagazine.com/celebrity-news/news/kim-kardashian-explains-how-north-west-posted-that-bikini-photo-of-her-i-swear-north-posted-this-w158488/.

33. Eric Griffith, *Two-Factor Authentication: Who Has It and How to Set It Up* (Mar. 11, 2020), https://www.pcmag.com/how-to/two-factor-authentication-who-has-it-and-how-to-set-it-up.

and their client will communicate confidentiality during a virtual hearing. This is a concern even if lawyer and client are in the same physical room but other parties are in a different space for a virtual hearing. If lawyer and client plan to participate in the virtual hearing from the same location, they should plan to mute the microphone if they will be engaging in a confidential conversation to protect it.[34] The lawyer should investigate the possibility of using a secure Zoom breakout room or secure chat during the hearing,[35] inquiring with FINRA whether such tools are available and who, if anyone, will have access to a breakout room, chat transcript, or recording of the proceeding. To ensure confidentiality, the lawyer and client may wish to discuss other ways they can communicate outside the FINRA-sponsored Zoom session, including via text message or phone. Even if a lawyer and a client are alone in a breakout room or in a chat, the host of the Zoom session may still be able to access their communication. In other words, confidential communication planning must be part of the discussion between client and lawyer as to whether to proceed virtually or not.

4. Practical Considerations Before Proceeding Virtually

If, after all these ethical considerations are evaluated, the client and lawyer tentatively elect to proceed virtually, they should participate in a Zoom test run with all other persons who might be involved in their presentation of the case, from co-counsel to experts. A test run should include ensuring that cameras and microphones work as intended. All involved should develop a plan outlining the steps they will take if there is a technological failure. Planning for breaks and ensuring confidential discussions between client and lawyer should also be undertaken. Zoom offers information on breakout rooms and troubleshooting on their support site[36] as well as online training sessions and

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34. Failing to mute a microphone has already led to parties hearing unintended sounds during virtual proceedings. *See, e.g.*, Allan Smith, *Justice Can't be Muted? Flushing Sound Heard on Supreme Court Conference Call* (May 6, 2020, 2:01 PM), https://www.nbcnews.com/politics/supreme-court/justice-can-t-be-muted-flushing-sound-heard-supreme-court-n1201346.

35. Zoom Help Center, available at https://support.zoom.us/hc/en-us/articles/206476093-Enabling-breakout-rooms (last accessed June 5, 2020).

36. Zoom Help Center, https://support.zoom.us/hc/en-us (last accessed June 8, 2020).

resources for best practices that should be consulted to ensure the platform is being used correctly and to its highest potential.[37]

COVID-19 delays present numerous decisions for clients and lawyers to make together. After understanding the technology and discussing the benefits and detriments of foregoing an in-person proceeding in lieu of proceeding virtually, some parties may elect a Zoom proceeding. Ethical concerns do not stop once a decision is made to move forward in a virtual hearing. Instead, online proceedings present their own concerns for which lawyers and their clients must prepare.

B. Ethical Considerations During the Virtual Proceeding

Though lawyers may assume that practicing remotely is inherently less formal, ethical responsibilities in an online proceeding are not relaxed. As an initial matter, lawyers must adhere to FINRA's guidelines for how a proceeding will progress or they may face disciplinary action.[38] Thus, lawyers should first familiarize themselves with FINRA's guidelines for online hearings.[39] That does not mean that reading the guidelines now ends the lawyer's responsibilities; instead, as the guidance will inevitably change and evolve with more virtual hearings, lawyers must keep up with those changes and be prepared to follow them.[40]

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37. *Training,* Zoom Help Center (June 8, 2020), https://support.zoom.us/hc/en-us/sections/201740096.

38. American Bar Association, *supra* note 21, at r. 3.4(c) (violation of ethical requirements to "knowingly disobey an obligation" of a tribunal).

39. *See,* FINRA, *FINRA Dispute Resolution Services Arbitrator Resource Guide for Virtual Hearings*, *supra* note 6.

40. *See* American Bar Association, *supra* note 21, at r. 1.1 cmt. [8] ("To maintain the requisite knowledge and skill [to meet the duty of competence], a lawyer should keep abreast of changes in the law and its practice, including the benefits and risks associated with relevant technology, engage in continuing study and education and comply with all continuing legal education requirements to which the lawyer is subject.").

1. Ensuring Fairness Through Advance Agreements Concerning Party and Witness Participation and Sequestration

What will not change is the lawyer's responsibilities to ensure fairness to opposing parties and their counsel in the conduct of the proceedings. Online hearings carry the benefit of allowing witnesses to appear without the added costs and difficulty of travel.[41] This benefit carries with it potential ethical detriments: the difficulty of ensuring the fairness of the forum when participants are dispersed across the country. Inappropriate interaction with and access to witnesses is chief among these concerns. For example, it would be difficult to ensure fairness if one attorney has physical access to a witness and another does not. First, building rapport with and assessing credibility is easier in a face-to-face interaction. An in-person attorney need not worry about not seeing a witness' facial expression or hearing everything that they say due to a technological glitch. Considering equal access to witnesses by all attorneys may eliminate these concerns. Similarly, a witness appearing live before a panel may be more compelling than a witness appearing remotely via teleconferencing software. Ensuring fairness during the course of the proceeding will require the parties and the panelists to discuss how each will present their cases and witnesses and evaluating potential biases or other disadvantages that might result if witnesses and parties appear in different modalities. When inequalities occur, all should consider leveling the playing field to a workable situation for each side. For example, if one side can meet in person with witnesses and the other cannot, then the parties should consider bringing in all witnesses virtually.[42] Like in-person proceedings, parties in virtual FINRA proceedings should ensure that proper sequestration rules are followed. Witnesses should not be able to access the proceeding except for the time that they are to testify. That means both that unauthorized parties should not be allowed into the Zoom hearing room until it is their turn to testify and that parties should not let someone off camera hear or see what is happening in a live FINRA hearing. FINRA's virtual hearing guidelines

41. Virtual Interview with Daniel Gonzalez, Samaa Haridi, and Jorge Mattamourus, *Navigating Virtual Arbitration Hearings in the Age of COVID-19* (May 6, 2020), available at https://www.americanbar.org/groups/dispute_resolution/resources/resources-for-mediating-online/navigating-virtual-arbitration-hearings-in-the-age-of-covid-19/.

42. *Id.*

address each of these concerns.[43] Zoom also provides a guide to using and customizing waiting rooms, which will be useful in preparation for an online hearing.[44]

2. Preventing *Ex Parte* Conversations

Ex parte conversations are a significant concern in virtual proceedings. If a virtual hearing room is opened before all parties and their counsel are present, the arbitrator may be participating in conduct that suggests they are not unbiased. At worst, if the panel member and counsel speak about the case, they are violating the ethical prohibition against *ex parte* conversations.[45] FINRA takes *ex parte* conversations seriously, prohibiting all parties and their representatives from communicating "with any arbitrator outside of a scheduled hearing or conference regarding an arbitration unless all parties or their representatives are present."[46] Traditionally, parties would not even ride the same elevator as an arbitrator to keep the proceedings fair and prevent against the appearance of any impropriety.[47] Today, logging into a live virtual hearing room call a few moments early can put parties at risk of appearing to engage in an inappropriate *ex parte* conversation. Thus, ensuring that panel members adhere to FINRA's guidance that waiting rooms be used in virtual hearings is especially important.

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43. FINRA Dispute Resolution Services, *Arbitrator Resource Guide for Virtual Hearings*, *supra* note 6, at 7 ("FINRA implements the following security measures for all arbitrations and mediations conducted by Zoom…Use of the 'waiting room feature' to ensure that only invited participants are admitted to the meeting.").

44. *Waiting Room, Zoom Help Center (June 8, 2020), available at https://support.zoom.us/hc/en-us/articles/115000332726-Waiting-Room#h_11875115-ac6e-491b-a594-548058954ad2.*

45. American Bar Association, *supra* note 21, at r. 3.5(c).

46. FINRA, Rule 12210(a) (2008).

47. *See, e.g.*, FINRA, *Office of Dispute Resolution Basic Arbitrator Training* at 61, available at https://www.finra.org/sites/default/files/FINRA-Basic-Arbitrator-Training.pdf (last accessed June 28, 2020) ("Ex parte communications may include any discussion between an arbitrator and a party, party representative, or witness when the other parties are not present. This includes pleasantries exchanged in the elevator, hallway, or restroom.").

3. Ensuring Security of Virtual FINRA Proceedings

In addition to preventing the appearance of impropriety, a Zoom waiting room also adds an additional layer of security to a meeting. The host is able to view anyone who is trying to join a meeting before they can. This prevents "Zoom bombers" from entering a meeting. A "Zoom bomber" is a bad actor who intrudes on a Zoom conference to cause mischief.[48] These unwanted intrusions can be prevented by not just employing a waiting room but also by updating Zoom, making unique ID and passwords for calls, making sure only hosts can share their screens, invite-only meetings, locking a meeting once it starts, and disabling/managing chats.[49] FINRA's virtual hearing guidance calls for the use of these tools to ensure that FINRA's security standards are met.[50]

4. Changes to the Chairperson's Opening Remarks and Party Affirmations

The panel's responsibilities do not end once they have ensured that the proceeding will be secure, and lawyers representing clients in a virtual FINRA proceeding should ensure that those responsibilities are met. FINRA Dispute Resolution Services has added information that should be included with the Chairperson's opening remarks.[51] First, the chair must seek affirmation from each participant that "[n]o unauthorized individuals are present in each participant's videoconferencing location" and may "require participants to scan their videoconference locations with the camera to show that there are no unauthorized individuals in the room."[52] Such measures will go further to ensure that there are no *ex parte* conversations and that witnesses are appropriately sequestered. The chair is tasked with creating "a back-up plan if a participant's power or internet connection is disconnected."[53] Throughout the proceeding, the meeting host (either the Chair or the Case Administrator)

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48. Jill Duffy, How to Prevent Zoom Bombing, available at https://www.pcmag .com/how-to/how-to-prevent-zoom-bombing.

49. *Id*.

50. FINRA, *Arbitrator Resource Guide for Virtual Hearings*, *supra* note 6, at 4-5.

51. *Id*. at 4.

52. *Id*.

53. *Id*.

should monitor the waiting room, ensure all participants are connected to the conference, and admit witnesses at the appropriate time.[54]

5. Monitoring Arbitrator Conduct Throughout the Virtual Hearing

Finally, lawyers should monitor arbitrator conduct just as they would in an in-person hearing to ensure there is no arbitrator misconduct that prejudices their client. In the past, parties have attempted to vacate arbitration awards for arbitrator misconduct such as sleeping during the proceeding.[55] Virtual hearings present opportunities for distraction and inattention that are not available in live proceedings. If an arbitrator needed a brief break for a glass of water, or to use the facilities, in a live proceeding, she would pause the proceedings and call for a short break. In a virtual hearing, it seems more natural to engage in these activities. Neither arbitrators nor the parties should do so, however.

An arbitrator turning off their camera or appearing to look at a document off the screen does not necessarily mean that misconduct has occurred. It does, however, raise questions for the parties, and at least one party has even leveraged alleged arbitrator inattention as part of a larger challenge to an arbitration award. In one of the first FINRA proceedings to involve the use of Zoom, the non-prevailing party filed a motion to vacate, alleging that the final day of the hearing, conducted via Zoom after multiple live hearing dates, included arbitrators turning off their camera, eating, and looking away from the screen.[56] While experts do not believe that these allegations are sufficient to overturn a FINRA award,[57] in its virtual hearing guide under the heading of

54. *Id*.

55. *See, e.g.*, Bill Singer, *Merrill Lynch Asks Court to Rule that Sleeping FINRA Arbitrator Engaged in Misconduct*, Forbes, available at https://www.forbes.com/sites/billsinger/2012/03/23/merrill-lynch-ask-court-to-rule-that-sleeping-finra-arbitrator-engaged-in-misconductle-may-not-be-evidence-of-misconduct/#4568e9282994 (last accessed June 28, 2020) (asserting, *inter alia*, that arbitration award should be vacated because arbitrator was sleeping during the hearing).

56. *See Wunderlich Sec., Inc. et al. v. Dominick & Dickerman, LLC, et al.*, Pet. to Vacate Arbitration Award, Civil Action No. 1:20-cv-03507-UA (SDNY May 5, 2020) ¶¶ 41-42.

57. Mark Schoeff, Jr., *Lawyers Slow to Embrace Zoom for FINRA Arbitration Hearings*, Investment News, available at https://www.investmentnews.com/finra-

"Dress and Etiquette," FINRA directs arbitrators "Do not turn off your video and always remain visible on camera to the parties during the virtual hearing. Don't walk around while on camera. If you need to leave the room, please announce it as you would if you were in-person."[58] Arbitrators are also directed to minimize distractions, including closing any computer application other than Zoom and documents related to the proceeding.[59] Nor should arbitrators engage in any multi-tasking, including checking email or texts.[60] After Dispute Resolution Services included these behaviors in its list of "don'ts" for virtual proceedings, counsel should be especially vigilant and immediately pause the hearing to raise a concern if they witness conduct that suggests a panel member is not fully engaged in the proceeding.

CONCLUSION

COVID-19 has brought significant changes to FINRA arbitration proceedings that pose ethical issues. Those issues can be addressed by revisiting core ethical principles relating to the client-lawyer relationship and the fair operation of the proceeding. As remote proceedings continue, more hazards will appear. Perhaps the most significant hazard is assuming that a virtual proceeding will be more informal because it is conducted in the participants' homes. Lawyers proceeding virtually should still exercise the same levels of professionalism they would exercise in a hearing room.[61] While this may not mean putting on shoes, presenting oneself professionally ensures the focus is on the client's case. Learn from a reporter who was live on Good Morning America without realizing the camera angle showed that he was wearing shorts with his blazer and tie.[62] Lawyers have drawn attention for

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arbitration-zoom-hearings-192787 (May 13, 2020) (quoting Lisa Braganca for prediction that losing party is unlikely to prevail in its challenge).

58. FINRA, *Arbitrator Resource Guide for Virtual Hearings*, *supra* note 6, at 6.

59. *Id*.

60. *Id*.

61. This admonition also applies to arbitrators. *See, e.g.*, FINRA, *Arbitrator Resource Guide for Virtual Hearings*, *supra* note 6, at 6, 7 ("Always look professional and dress as if you are meeting in-person.").

62. Hannah Yasharoff, *Viral reporter returns to 'GMA' after 'hilariously mortifying' video appearance with no pants*, available at https://www.usatoday.com/story/

similar behavior. One judge recounted a story: a "male lawyer appeared shirtless and one female attorney appeared still in bed, still under the covers."[63] Should the parties decide to move forward, a virtual FINRA proceeding should be approached as if all the parties are in a FINRA hearing room, with lawyers taking stock of and preparing for ethical challenges that might arise.

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entertainment/tv/2020/04/28/quarantine-woes-gma-abc-reporter-mistakenly-appears-tv-without-pants/3039932001/ (last accessed June 8, 2020).

63. *A Letter from the Honorable Dennis Bailey*, available at https://www.westonbar.org/so/61N5VoOJe?fbclid=IwAR3gBGUaUfpC8qs0612nMrw-lSDgZkDFiOiCcKGXBjd3SDS8PisCrslHN6c#/main (last accessed June 8, 2020).

AN OVERVIEW OF THE REGULATION BEST INTEREST RULE PACKAGE

Christine Lazaro

On June 5, 2019, the SEC adopted the Regulation Best Interest Rule Package. The package consists of (I) Regulation Best Interest: The Broker-Dealer Standard of Conduct;[1] (II) Form CRS Relationship Summary and Amendments to Form ADV;[2] (III) the SEC Interpretation Regarding Standard of Conduct for Investment Advisers;[3] and (IV) the SEC Interpretation Regarding the "Solely Incidental" Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser.[4] Each of these four releases is summarized below. Additionally, FINRA has issued its own rules changes in response to the adoption of Regulation Best Interest. FINRA's changes are also discussed below.

I. Regulation Best Interest

a. General Obligation

Regulation Best Interest requires that brokerage firms and their brokers must act in the best interests of their retail customers when making recommendations of securities or investment strategies.[5] Put simply, the

1. Regulation Best Interest: The Broker-Dealer Standard of Conduct, 17 C.F.R. § 240.15 ***l***-1 (2019).

2. Form CRS Relationship Summary; Amendments to Form ADV, 84 Fed. Reg. 33,492 (July 12, 2019) (to be codified at 17 C.F.R. pts. 200, 240, 249, 275, and 279).

3. Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 Fed. Reg. 33,669 (July 12, 2019).

4. Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion From the Definition of Investment Adviser, 84 Fed. Reg. 33,681 (July 12, 2019).

5. 17 C.F.R. §240.15 ***l*** -1(a)(1) (2019).

brokerage firm and the broker may not place their own interests ahead of the customers' interests.[6]

For purposes of this standard, the term "recommendation" has the same meaning that it currently has under FINRA rules.[7] It is a fact-based determination.[8] The SEC recognizes that factors to consider are "whether the communication 'reasonably could be viewed as a 'call to action'' and 'reasonably would influence an investor to trade a particular security or group of securities.'"[9]

The SEC provides some guidance as to what would not be considered a recommendation, including communications such as general financial and investment information; descriptive information about an employer-sponsored retirement plan; certain asset allocation models; and interactive investment materials incorporating those topics.[10]

Recommendations include, for example, advice about the type of securities account to open, as well as advice to roll over or transfer assets from one account to another.[11] Additionally, a broker may be deemed to have made an implicit hold recommendation, triggering the obligations of the Rule, if the broker has agreed to perform periodic account monitoring.[12]

Brokerage firms and brokers owe this obligation to "retail customers." The SEC defines retail customer to focus on natural persons and their legal representatives, seeking advice for personal, family, or household purposes.[13]

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6. *Id.*

7. Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318, 33,337.

8. *Id.* at 33,335 ("[W]hether a broker-dealer has made a recommendation that triggers application of Regulation Best Interest should turn on the facts and circumstances of the particular situation and therefore, whether a recommendation has taken place is not susceptible to a bright line definition.").

9. *Id.*

10. *Id.* at 33,337-38.

11. *Id.* at 33,338.

12. *Id.* at 33,340.

13. 17 C.F.R. §240.15 ***l*** -1(b)(1) (2019).

b. Component Obligations

Regulation Best Interest is comprised of four components: (i) the Disclosure Obligation; (ii) the Care Obligation; (iii) the Conflict of Interest Obligation; and (iv) the Compliance Obligation.[14]

i. Disclosure Obligation

The Disclosure Obligation requires that a broker or brokerage firm make full and fair disclosure in writing of "material facts relating to the scope and terms of the relationship" with the customer; and "material facts relating to such conflicts of interest that are associated with the recommendation."[15] "Materiality" has the same meaning that the Supreme Court articulated in *Basic v. Levinson*.[16]

Material facts related to the scope of the relationship explicitly include the following types of information: (i) the capacity in which the broker is acting (as a broker-dealer or investment adviser); (ii) fees and costs associated with the transactions and the accounts more generally; and (iii) the type and scope of services the brokerage firm will offer, including any limitations on those services.[17]

Regardless of whether the firm and individual are dually-registered, both still have to disclose the capacity in which they are acting. If the firm or individual is not dually-registered but uses the term "advisor" or "adviser", they will likely be in violation of this obligation because their disclosure about capacity will not be accurate.[18]

With respect to fees and costs, the SEC expects that brokerage firms will build on the disclosure of fees and costs that are set forth in Form CRS (to be discussed in further detail below).[19] The obligation does not require that the brokerage firm provide "individualized" costs and fees, but rather may provide

14. 17 C.F.R. §240.15*l*-1(a)(2) (2019).

15. 17 C.F.R. §240.15*l*-1(a)(2)(i) (2019).

16. 84 Fed. Reg. at 33,347. *See also Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).

17. 84 Fed. Reg. at 33,349.

18. *Id.* at 33,352.

19. *Id.* at 33,354.

standardized or hypothetical amounts or percentage ranges.[20] Brokerage firms may also satisfy this part of their disclosure obligations by providing mandated disclosure documents, such as prospectuses, and trade confirmations.[21]

With respect to the type of services the brokerage firm offers, the firm must disclose whether it monitors transactions and strategies.[22] As part of this disclosure, the brokerage firm must be specific as to the frequency and duration of the services offered.[23] The brokerage firm may rely on information disclosed in the Form CRS (as will be discussed below), but it will likely need to expand on that information to meet this disclosure obligation.[24] However, the brokerage firm may rely on other documents, including account agreements, to make these disclosures.[25] As part of this disclosure, brokerage firms must also disclosure whether they require any account balance minimums.[26]

The brokerage firm must also disclose any limitations on its offerings.[27] Limitations include for example, if the brokerage firm only offers proprietary products.[28] Additionally, if the brokerage firm is dually registered but the broker is not, the broker must disclose that he cannot offer advisory services.[29]

The conflicts of interest disclosure obligation should summarize how the brokerage firm and the brokers are compensated for their recommendations as well as the conflicts that the compensation arrangements create.[30] These conflicts need not be disclosed on a recommendation by recommendation basis.[31]

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20. *Id.* at 33,355.

21. *Id.*

22. *Id.* at 33,356.

23. *Id.*

24. *Id.* at 33,357.

25. *Id.*

26. *Id.* at 33,358.

27. *Id.* at 33,357.

28. *Id.*

29. *Id.*

30. *Id.* at 33,363.

31. *Id.*

While the disclosure obligation requires that the disclosures be made in writing, the SEC recognizes that it may be necessary to supplement, clarify, or update written disclosures with oral disclosures.[32] If the brokerage firm does supplement the written disclosures, however, the brokerage firm must keep a record of the fact that an oral disclosure was provided.[33]

ii. Care Obligation

The Care Obligation, in many ways, mirrors the FINRA Suitability Rule. It requires that the broker, when making a recommendation, exercise "reasonable diligence, care, and skill to:"

(A) Understand the potential risks, rewards, and costs associated with the recommendation, and have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers;

(B) Have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation and does not place the financial or other interest of the broker, dealer, or such natural person ahead of the interest of the retail customer; and

(C) Have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile and does not place the financial or other interest of the broker, dealer, or such natural person making the series of recommendations ahead of the interest of the retail customer.[34]

The first prong is similar to the "reasonable basis" obligation under the FINRA Suitability Rule.[35] As a threshold issue, the broker must understand the security or investment strategy recommended before being capable of determining whether the recommendation is in the best interest of a particular

32. *Id.* at 33,368.

33. *Id.*

34. 17 C.F.R. §240.15*l*-1(a)(2)(ii) (2019).

35. *See* FINRA Rule 2111.05(a) (2020).

customer.[36] The SEC sets forth factors that the broker or brokerage firm should consider when investigating the security or investment strategy: "the security's or investment strategy's investment objectives, characteristics (including any special or unusual features), liquidity, volatility, and likely performance in a variety of market and economic conditions; the expected return of the security or investment strategy; as well as any financial incentives to recommend the security or investment strategy."[37]

The SEC has included "costs" as a factor in evaluating securities or strategies because it recognizes that cost will always be a relevant factor.[38] "Costs" includes both costs associated with purchasing a security, as well as future costs associated with exchanging or selling a security.[39] However, the SEC cautions that cost is not a dispositive factor. The Rule does not require that a broker recommend the lowest cost option.[40]

The second prong incorporates the "customer specific" prong of the FINRA Suitability Rule,[41] but enhances it by replacing "suitable" with a best interest standard.[42] In sum, the broker must determine that a recommendation is in the customer's best interest based on that customer's investment profile. The customer's investment profile includes "age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance," and any other information that the customer may have disclosed.[43] This is the same information that firms must currently consider as part of the investor's profile under the FINRA Suitability Rule.[44] If a customer does not provide the information, the SEC cautions that a firm may not have sufficient information to make a best interest determination.[45]

36. 84 Fed. Reg. at 33,375-76.

37. *Id.* at 33,376.

38. *Id.* at 33,372-73.

39. *Id.* at 33,373.

40. *Id.*

41. *See* FINRA Rule 2111.05(b).

42. 84 Fed. Reg. at 33,377.

43. 17 C.F.R. §240.15*l*-1(b)(3) (2019).

44. *See* FINRA Rule 2111(a).

45. 84 Fed. Reg. at 33,379.

In evaluating whether a recommendation is in the customer's best interest, the broker should consider reasonably available alternatives offered by the broker's firm.[46] The broker need not recommend the "best" of all possible alternatives.[47] The Rule also does not require that the broker be familiar with every product available by the brokerage firm.[48] The scope of the reasonably available alternatives that are considered with respect to any particular recommendation will depend on several factors, including, the broker's customer base; the products available to the broker to recommend; and specific limitations on the available products, including that products may only be available in certain geographical locations or to particular types of accounts.[49] For dually registered brokers, the options with respect to account type must be considered as reasonably available alternatives.[50] If the broker may only offer brokerage accounts, the broker must consider the customer's objectives before recommending a brokerage account.[51] For example, if the customer is requesting that the broker have unlimited discretion, a brokerage account would not be appropriate.[52]

When recommending a rollover, the broker must consider a number of factors, including, "fees and expenses; level of service available; available investment options; ability to take penalty-free withdrawals; application of required minimum distributions; protection from creditors and legal judgments; holdings of employer stock; and any special features of the existing account."[53] A broker may not just consider whether the rollover may offer additional options beyond the customer's current plan.

The final component is similar to the "quantitative suitability" requirement,[54] except that the "control" element has been eliminated.[55] This

46. *Id.* at 33,381.

47. *Id.*

48. *Id.*

49. *Id.* at 33,382.

50. *Id.* at 33,383.

51. *Id.*

52. *Id.*

53. *Id.*

54. *See* FINRA Rule 2111.05(c).

55. 84 Fed. Reg. at 33,384.

component is intended to prevent trading that is so excessive that a positive return is virtually impossible.[56]

iii. Conflict of Interest Obligation

The Conflict of Interest Obligation requires a firm to adopt policies and procedures designed to identify and, at a minimum, disclose all conflicts associated with a recommendation.[57] The obligation further requires that a brokerage firm mitigate or eliminate certain types of conflicts.[58]

With respect to the content of the policies and procedures, the SEC contemplates that brokerage firms will have the flexibility to design policies and procedures that are risk-based rather than requiring a detailed review of each recommendation.[59] The SEC suggests certain components that a brokerage firm should consider when adopting policies and procedures including:

> [P]olicies and procedures outlining how the firm identifies conflicts, identifying such conflicts and specifying how the broker-dealer intends to address each conflict; robust compliance and monitoring systems; processes to escalate identified instances of noncompliance for remediation; procedures that designate responsibility to business line personnel for supervision of functions and persons, including determination of compensation; processes for escalating conflicts of interest; processes for periodic review and testing of the adequacy and effectiveness of policies and procedures; and training on policies and procedures.[60]

Under this obligation, the brokerage firm has a duty to, at a minimum, disclose all conflicts of interest.[61] Disclosure must be full and fair; if it is not

56. *Id.*

57. 17 C.F.R. §240.15*l*-1(a)(2)(iii)(A) (2019).

58. 17 C.F.R. §240.15*l*-1(a)(2)(iii)(B) (2019).

59. 84 Fed. Reg. at 33,386.

60. *Id.* at 33,386 n.688.

61. *Id.* at 33,388.

possible to fully and fairly disclose a conflict, it must be mitigated such that full and fair disclosure is possible.[62]

Brokerage firms also have a duty to identify and mitigate conflicts of interest that create an incentive for the broker to place the interests of the broker or the firm ahead of the interests of the customer.[63] The SEC has primarily chosen to limit the duty to mitigate to broker-level conflicts, allowing the brokerage firms to generally deal with firm-level conflicts through disclosure.[64] The requirement to identify and mitigate broker-level conflicts applies only to incentives provided to the broker, either by the firm or third parties that are within the control of or associated with the firm.[65] Accordingly, the requirement does not create an obligation with respect to private securities transactions.[66] The SEC does provide examples of conflicts that must be mitigated: (i) compensation from the brokerage firm or third parties, including fees and other charges associated with the service or recommendation provided; (ii) employment incentives, including those tied to asset accumulation, special awards, variable compensation, and compensation tied to performance reviews; and (iii) commissions, sales charges, or other fees whether paid by the customer, the brokerage firm, or a third party.[67]
Mitigation measures should be based on the nature and significance of the incentive, as well as other factors related to the brokerage firm's business model, such as the size of the firm, the types of customers, and the complexity of the security product or strategy.[68]

The SEC provides a list of best practices for brokerage firms developing policies and procedures for mitigation methods:

- Avoiding compensation thresholds that disproportionately increase compensation through incremental increases in sales;
- Minimizing compensation incentives for employees to favor one type of account over another; or to favor one type of product over another, proprietary or preferred provider products, or comparable products

62. *Id.* at 33,388-89.

63. *Id.* at 33,390.

64. *Id.*

65. *Id.* at 33,391.

66. *Id.* at *note* 744.

67. *Id.* at 33,391.

68. *Id.*

sold on a principal basis, for example, by establishing differential compensation based on neutral factors;

- Eliminating compensation incentives within comparable product lines by, for example, capping the credit that an associated person may receive across mutual funds or other comparable products across providers;
- Implementing supervisory procedures to monitor recommendations that are: near compensation thresholds; near thresholds for firm recognition; involve higher compensating products, proprietary products or transactions in a principal capacity; or, involve the roll over or transfer of assets from one type of account to another (such as recommendations to roll over or transfer assets in an ERISA account to an IRA) or from one product class to another;
- Adjusting compensation for brokers who fail to adequately manage conflicts of interest; and
- Limiting the types of retail customer to whom a product, transaction or strategy may be recommended.[69]

If a brokerage firm materially limits its securities offerings or investment strategies, the brokerage firm must prevent such limitations from causing the firm to put its interests ahead of the customers'.[70] The SEC considers that recommending only proprietary products, products with revenue sharing arrangements, or a specific asset class would be material limitations.[71] The SEC recommends that brokerage firms offering limited menus consider establishing a "product review process" that includes evaluating the use of preferred lists; restrictions on the customers to whom a product may be sold; requiring brokers selling certain products to have minimum knowledge requirements; as well as period product reviews to further evaluate conflicts.[72] Certain practices are completely prohibited pursuant to this obligation. For example, brokerage firms must eliminate "sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited time."[73] Non-cash compensation includes merchandise, gifts and prizes, travel expenses, meals

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69. *Id.* at 33,392.

70. *Id.* at 33,393.

71. *Id.*

72. *Id.* at 33,394.

73. 17 C.F.R. §240.15*l*-1(a)(2)(iii)(D) (2019).

and lodging.[74] This obligation is not intended to eliminate all incentives, only those that create high-pressure situations to sell specific securities within a limited period of time.[75] It likely will not capture contests or other incentives tied to total products sold or asset accumulation and growth.[76] Brokerage firms may also continue to hold annual conferences, so long as attendance is not premised on the sale of specific securities within a limited period of time.[77]

iv. Compliance Obligation

The Compliance Obligation is an overarching requirement to adopt policies and procedures that are reasonably designed to achieve compliance with the Rule as a whole.[78] The Rule does not specify which policies and procedures must be adopted. The SEC expects brokerage firms to design policies and procedures that "prevent violations from occurring, detect violations that have occurred, and to correct promptly any violations that have occurred."[79] Brokerage firms are expected to tailor their policies and procedures to account for the "scope, size, and risks associated with the operations of the firm and the type of business in which the firm engages."[80]

II. Form CRS Relationship Summary

In addition to adopting a new standard of conduct for brokers and brokerage firms, the SEC also adopted a new disclosure obligation for both brokerage firms and investment advisers.[81] The SEC will require that brokerage firms and investment advisers create and deliver a relationship summary to prospective and existing customers. The relationship summary and the firms' delivery obligations are described in this section.

74. 84 Fed. Reg. at 33,396.

75. *Id.*

76. *Id.*

77. *Id.* at 33,396-97.

78. 17 C.F.R. §240.15*l*-1(a)(2)(iv) (2019).

79. *Id.* at 33,397.

80. *Id.*

81. 84 Fed. Reg. 33,492.

a. Presentation and Format

The SEC allows firms to use a mix of prescribed wording along with firm-authored wording in drafting the relationship summary.[82] For example, firms will be able to describe their services, investment offerings, fees, and conflicts of interest.[83] Firms will be required, however, to use prescribed headings, conversation starters, and a statement describing their standard of conduct when providing investment advice.[84]

The SEC requires that headings be in the form of prescribed questions, in a set order.[85] The relationship summary may not exceed four pages for a dual registrant that includes both its brokerage and advisory services in a single summary.[86] Otherwise, the relationship summary may not exceed two pages for brokerage firms and investment advisers that are describing one of their services.[87]

The SEC is encouraging the use of graphics to facilitate comprehension, including charts, graphs, tables, text colors, and graphical cues such as dual-column charts.[88] Additionally, firms may include QR codes and hyperlinks to facilitate layered disclosure.[89] However, a firm may not satisfy its disclosure obligations of the relationship summary through the use of "incorporation by reference."[90]

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82. *Id.* at 33,502.

83. *Id.*

84. *Id.*

85. *Id.* at 33,504.

86. *Id.* at 33,505.

87. *Id.*

88. *Id.* at 33,506-07.

89. *Id.*

90. *Id.* at 33,508.

b. Content

i. Introduction

Firms are required to open the relationship summary with a standardized introduction that includes (i) the name of the firm and whether it is a brokerage firm or investment adviser; (ii) a statement that brokerage and advisory services and fees differ; and (iii) a statement that research tools are available at Investor.gov/CRS.[91]

ii. Relationships and Services

Following the introduction, firms must summarize the relationships and services that they offer under the heading, "What investment services and advice can you provide me?"[92] Additionally, firms must include any material limitations on the services that they offer to investors.[93] In the description of services, firms must address (i) monitoring; (ii) investment authority; (iii) limited investment offerings; and (iv) account minimums and other requirements.[94]

With respect to monitoring, firms must explain whether they monitor an investor's accounts, including the frequency of the monitoring and any limitations on the monitoring.[95] If an investment adviser accepts discretionary authority, the firm must describe how the authority will be exercised.[96] For example, if the firm requires investor input before exercising discretion in certain circumstances, the firm must explain that.[97] Both investment advisers and brokerage firms that offer non-discretionary services must explain that the investor is the ultimate decision-maker.[98] If a firm has a limited menu of offerings, such as only proprietary products or a specific asset class, the firm

91. *Id.* at 33,513.

92. *Id.* at 33,515.

93. *Id.* at 33,516.

94. *Id.* at 33,517.

95. *Id.* at 33,518.

96. *Id.* at 33,518-19.

97. *Id.* at 33,519.

98. *Id.*

must explain those limitations.[99] Firms must also disclose whether there are any required minimums to open an account or place a trade, or if there is a tiered fee schedule.[100]

In the relationship and services section of the form, firms must also provide additional information that further explains the firms' services.[101] This section should provide the information about services that would be available in an investment adviser's Form ADV, Part 2A brochure, or that a brokerage firm otherwise has to provide under Reg. BI.[102] This section of the disclosure may be layered, providing hyperlinks or other ways of directing the investor to the source of the information.[103]

The relationship and services section will also contain three conversation starters.[104] The first conversation starter will be tailored to the nature of the firm's business. For firms that are not dual registrants, the firm will include, "Given my financial situation, should I choose a brokerage service? Why or why not?" or "Given my financial situation, should I choose an investment advisory service? Why or why not?"[105] Dual registrants will include, "Given my financial situation, should I choose an investment advisory service? Should I choose a brokerage service? Should I choose both types of services? Why or why not?"[106]

Additionally, firms will also include the following two questions: (i) "How will you choose investments to recommend to me?;" and (ii) "What is your relevant experience, including your licenses, education and other qualifications? What do these qualifications mean?"[107]

99. *Id.* at 33,520.

100. *Id.* at 33,520-21.

101. *Id.* at 33,521

102. *Id.*

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.*

107. *Id.*

iii. Summary of Fees, Costs, Conflicts, and Standards of Conduct

Firms will begin the discussion of fees, costs, conflicts, and standards of conduct with the heading, "What fees will I pay?"[108] In this section, the firm must summarize the principal costs and fees that investors will incur, including how frequently they are assessed and what conflicts of interest the fees may create.[109] Additionally, firms must describe other fees and costs associated with their services or investments, whether paid directly or indirectly.[110] The SEC provides some examples of the other fees and costs that may need to be disclosed, including: custodian fees; account maintenance fees; fees related to mutual funds and variable annuities; distribution fees; platform fees; and shareholder servicing fees.[111]

Finally, firms are required to include the following statement: "You will pay fees and costs whether you make or lose money on your investments. Fees and costs will reduce any amount of money you make on your investment over time. Please make sure you understand what fees and costs you are paying."[112] Firms must also include a conversation starter about fees: "Help me understand how these fees and costs might affect my investments. If I give you $10,000 to invest, how much will go to fees and costs, and how much will be invested for me?"[113]

Following the fees and costs discussion, firms must discuss the legal standard of conduct that applies, using prescribed language.[114] Additionally, this section must include a summary of certain firm-level conflicts.[115]

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108. *Id.* at 33,524.

109. *Id.*

110. *Id.* at 33,526.

111. *Id.*

112. *Id.* at 33,527.

113. *Id.* at 33,528.

114. *Id.* at 33,530.

115. *Id.* at 33,529.

The disclosure that a firm has to make will vary based on whether it is [a broker making a recommendation], [an investment adviser], or [a dual registrant]:

> [***When we provide you with a recommendation,***] [***When we act as your investment adviser,***] [***When we provide you with a recommendation as your broker-dealer or act as your investment adviser,***] we have to act in your best interest and not put our interest ahead of yours. At the same time, the way we make money creates some conflicts with your interests. You should understand and ask us about these conflicts because they can affect the [recommendations] [investment advice] [recommendations and investment advice] we provide you. Here are some examples to help you understand what this means.[116]

Following the prescribed wording, a firm must summarize the following ways that the firm makes money that involve conflicts: (i) from proprietary products; (ii) from third-party payments; (iii) by revenue sharing; and (iv) by principal trading.[117] If the firm does not have any of these conflicts, it must describe one material conflict of interest that will affect retail investors.[118]
In this section, firms must include the following conversation starter: "How might your conflicts of interest affect me, and how will you address them?"[119] Finally, firms must include the heading, "How do your financial professionals make money?" and include a description of how their financial professionals are compensated, including both cash and non-cash compensation, as well as the conflicts that the payments create.[120]

iv. Disciplinary History

The relationship summary will also include a section about whether the firm or its financial professionals have any disciplinary history, as well as where an investor may find additional information.[121] This section will begin

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116. *Id.* at 33,532–33 nn.507–09.

117. *Id.* at 33,533.

118. *Id.*

119. *Id.* at 33,535.

120. *Id.* at 33,536.

121. *Id.*

with the following question: "Do you or your financial professionals have legal or disciplinary history?"[122] Firms will have to answer yes if they have any of a number of disclosable events as set forth in the instructions.[123] For example, firms will have to answer yes if a broker has any items disclosed pursuant to question 14 A though M on the Form U4.[124]

This section must also include the following conversation starter: "As a financial professional, do you have any disciplinary history? For what type of conduct?"[125]

v. Additional Information

The final section of the relationship summary will state where the investor can find additional information.[126] This section will also include the following conversation starters: "Who is my primary contact person? Is he or she a representative of an investment adviser or a broker-dealer? Who can I talk to if I have concerns about how this person is treating me?"[127] Finally, this section must include a phone number where investors can request up-to-date information as well as a copy of the relationship summary.[128]

c. Filing, Delivery, and Updating Requirements

Firms must file the relationship summary with the SEC; and the SEC will make the forms publicly available through the website, Investor.gov.[129] Additionally, firms must make the forms available on their own websites.[130]

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122. *Id.* at 33,537.

123. *Id.* at 33,537 – 33,538.

124. *Id.* at 33,538.

125. *Id.* at 33,539.

126. *Id.*

127. *Id.* at 33,540.

128. *Id.*

129. *Id.* at 33,545.

130. *Id.*

Firms may deliver the relationship summary electronically, so long as the firm complies with the SEC's rules regarding electronic delivery.[131] Essentially, the firm must make the investor aware that the form is available electronically; the access to the information must be comparable to that which would have been provided in paper form; and the firm must maintain evidence of delivery.[132]

Brokerage firms must deliver the relationship summary before or at the earliest of: (i) a recommendation as to account type, a securities transaction, or an investment strategy; (ii) placing an order; or (iii) opening a brokerage account.[133] Investment advisers must deliver the relationship summary before or at the time of entering into an investment advisory contract with an investor.[134]

After the initial delivery of the form, firms must re-deliver the relationship summary whenever: (i) an account is opened that is different than the investor's existing account(s); (ii) there is a recommendation to roll over assets; or (iii) there is a recommendation for a new service or product that would not be held in an existing account.[135] This last item contemplates recommendations for investments such as direct-sold mutual funds or insurance products.[136]

Finally, firms must update the relationship summary within 30 days whenever the relationship summary becomes materially inaccurate.[137] At that time, the revised relationship summary must be filed with the SEC and posted to the firm's website.[138] Firms will have 60 days to deliver the revised relationship summary to existing clients.[139] When delivering the revised relationship summary, firms must highlight any changes by either marking the revised text or including a summary of the changes.[140]

131. *Id.* at 33,546-47.

132. *Id.* at 33,547.

133. *Id.* at 33,550.

134. *Id.* at 33,551.

135. *Id.* at 33,552.

136. *Id.*

137. *Id.* at 33,554.

138. *Id.*

139. *Id.*

140. *Id.*

III. Investment Adviser Interpretation

As part of the Regulation Best Interest Rule package, the SEC issued an interpretation of the investment adviser standard of conduct.[141] The SEC recognized that the investment adviser's fiduciary duty follows the contours of the relationship with the client.[142] Further, an investment adviser can shape that relationship by agreement, so long as there is full and fair disclosure, and informed consent by the client.[143] The specific duties that an investment adviser owes to a client will depend on the services that the adviser has agreed to perform for the client.[144] However, an investment adviser cannot have a client waive the fiduciary duty.[145]

a. Duty of Care

An investment adviser's fiduciary duty includes a duty of care. This duty includes: (i) the duty to provide advice that is in the best interest of the client; (ii) the duty to seek best execution of a client's transactions where the adviser has the duty to select the broker-dealer that will execute the client's trades; and (iii) the duty to provide advice and monitoring over the course of the relationship.[146]

The duty to provide advice that is in the best interest of the client is a duty to provide advice that is suitable for the client.[147] To be able to satisfy this duty, the investment adviser must make a reasonable inquiry into the client's financial situation, financial sophistication, investment experience, and financial goals, among other things.[148] Further, the investment adviser must determine that the client can and is willing to tolerate the risks of any

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141. 84 Fed. Reg. 33,669.

142. *Id.* at 33,671.

143. *Id.*

144. *Id.*

145. *Id.* at 33,672.

146. *Id*.

147. *Id.*

148. *Id.* at 33,673.

recommended investment, and that the potential benefits of the investment recommendation justify the risks.[149]

Next, the investment adviser must conduct a reasonable investigation into the investment being recommended.[150] As part of the investigation, the investment adviser must consider a number of factors relating to the investment, including the cost associated with the investment advice; as well as the investment product's or strategy's investment objectives, characteristics, liquidity, risks and potential benefits, volatility, likely performance in a variety of market and economic conditions, time horizon, and cost of exit.[151] This duty applies to advice about investment strategy, engaging a sub-adviser, and account type.[152] Accordingly, advice to open a particular type of account (brokerage or investment advisory) as well as advice about rolling over assets would trigger this duty.[153]

In seeking best execution, an investment adviser must try to execute trades such that the costs or proceeds from each transaction are the most favorable for the client.[154]

The duty to monitor means the investment adviser must monitor a client's account at a frequency that is in the best interest of the client.[155] However, if the investment adviser has been engaged for a limited duration, such as for the provision of a one-time financial plan for a one-time fee, the investment adviser is unlikely to have a duty to monitor.[156]

149. *Id.*

150. *Id.* at 33,674.

151. *Id.*

152. *Id.*

153. *Id.*

154. *Id.*

155. *Id.* at 33,675.

156. *Id.*

b. Duty of Loyalty

In simple terms, an investment adviser has a duty of loyalty, which prohibits the investment adviser from subordinating its clients' interests to its own.[157] As part of this duty, the investment adviser must make full and fair disclosure of any material facts relating to the advisory relationship.[158]

Additionally, the investment adviser must eliminate or at least expose through full and fair disclosure all conflict of interest that might incline an adviser to render advice that is not disinterested.[159] For disclosure to be full and fair, the disclosure must be specific enough so that the client can understand the material fact or the conflict of interest and be able to make an informed decision as to whether to provide consent.[160]

As part of its disclosure, an investment adviser may not state that the adviser "may" have a conflict if the conflict actually exists; however, "may" could be appropriate if the conflict does not currently exist but might reasonably present itself in the future.[161] In other words, disclosure will not be full and fair if the adviser states that a conflict "may" exist if the conflict already does exist.

Investment advisers do not have to determine whether the client actually understood the disclosure that was made.[162] The investment adviser merely has to put the client into the position to be able to understand the disclosure.[163] However, if the investment adviser actually knows, or reasonably should know, that the client does not understand the disclosure, the adviser cannot accept the client's consent.[164]

If the conflict is of a nature and to an extent that it would be difficult to be able to fully explain the conflict in a way that it could be understood by a client, the investment adviser must eliminate or mitigate the conflict.[165]

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157. *Id.*

158. *Id.*

159. *Id.* at 33,676.

160. *Id.*

161. *Id.* at 33,676-77

162. *Id.* at 33,677.

163. *Id.*

164. *Id.*

165. *Id.*

IV. Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser

In the last item of the Regulation Best Interest Rule package, the SEC provided an interpretation of the "solely incidental" prong of the broker-dealer exclusion from the definition of "investment adviser."[166] In this interpretation, the SEC clarified that if a broker exercises unlimited discretion, such conduct would not be "solely incidental" to the business of the broker-dealer, and accordingly, the brokerage firm would meet the definition of investment adviser.[167] However, discretion that is temporary or limited in scope would not necessarily turn a brokerage firm into an investment adviser.[168]

With respect to monitoring a customer's account, if the monitoring is at specific intervals for the purpose of determining whether to provide a buy, sell, or hold recommendation, such conduct would be considered "solely incidental" to the broker-dealer's primary business of effecting securities transactions.[169] It would not turn the brokerage relationship into an advisory relationship.

V. FINRA Changes and Guidance

On June 19, 2020, FINRA issued Regulatory Notice 20-18, "Reg BI-Related Changes to FINRA Rules."[170] FINRA has explained that FINRA Rule 2111 (the "Suitability Rule") will not apply to recommendations subject to Regulation Best Interest.[171] FINRA also explained that there remained certain recommendations to which Regulation Best Interest would not apply.[172] For example, Regulation Best Interest only applies to recommendations to retail customers seeking advice for personal, family, or household purposes.

166. 84 Fed. Reg. 33,681.

167. *Id.* at 33,686.

168. *Id.*

169. *Id.* at 33,687.

170. FINRA Reg. Notice 20-18, "Reg BI-Related Changes to FINRA Rules" (June 19, 2020), available at https://www.finra.org/sites/default/files/2020-06/Regulatory-Notice-20-18.pdf.(last accessed Aug. 30, 2020).

171. *Id.* at 2. *See also* FINRA Rule 2111.08.

172. FINRA Reg. Notice 20-18 at 2 n.3.

Accordingly, the Suitability Rule would continue to apply to recommendations to entities and institutions, such as pension funds.[173] The Suitability Rule will also apply to recommendations made to natural persons who will not be using the investment recommendation for personal, family, or household purposes, such as small business owners or charitable trusts.[174] In those instances when the Suitability Rule would apply, FINRA has modified the quantitative suitability component to remove the control element, thereby making it consistent with Regulation Best Interest.[175]

Finally, certain FINRA rules restrict, but do not forbid, the payment and receipt of non-cash compensation in connection with the sale and distribution of certain types of securities, including direct participation programs, variable insurance contracts, and investment company securities.[176] As discussed above, Regulation Best Interest requires firms to eliminate non-cash compensation that is based on the sales of specific securities or specific types of securities within a limited time. Accordingly, to the extent the referenced FINRA rules permit non-cash compensation, FINRA makes it clear that such compensation must be consistent with the requirements of Regulation Best Interest.[177] The changes set forth in the Regulatory Notice were effective on June 30, 2020, the compliance date of Regulation Best Interest.[178]

173. *Id*.

174. *Id.*

175. *Id.* at 2. *See also* FINRA Rule 2111.05(c).

176. *See* FINRA Reg. Notice 20-18 at 2. *See also* FINRA Rules 2310, 2320, 2341, and 5110.

177. FINRA Reg. Notice 20-18 at 2. *See also* FINRA Rules 2310(c)(2), 2320(g)(4), 2341(l)(5), 5110(h)(2).

178. FINRA Reg. Notice 20-18 at 1.

REPRESENTING CLIENTS WITH DIMINISHED CAPACITY

Nicole G. Iannarone and Mary Kate McDevitt[*]

INTRODUCTION

Lawyers representing clients in securities arbitration proceedings often face concerns related to the potential diminished capacity of their clients. This is particularly so because a high proportion of investors with FINRA arbitration claims are advanced in age. America is rapidly becoming much older, making it more important than ever that attorneys representing investors in securities arbitration proceedings be attuned to the ethical considerations that come into play should their clients present signs of impairment.

In this article, we begin by discussing the risk of diminished capacity, including how it may manifest in a lawyer's clients. In section II, we describe the ethical rules that govern an attorney's representation of a client who exhibits signs of diminished capacity. Finally, in section III, we conclude with a list of resources and additional information to assist attorneys as they navigate representing a client who exhibits diminished capacity.

This article is an intentionally short, high-level overview of ethical considerations and resources for lawyers who are concerned that their clients are exhibiting signs of diminished capacity and need guidance for the steps to take upon coming to that realization.

I. DIMINISHED CAPACITY: RISK AND TYPES

In recent years, the United State Census Bureau has made a remarkable projection that "older people" will outnumber children for the first time in U.S. history.[1] Today, nearly 45 million Americans are 65 or older, a number that is expected to increase by 30 million before the year 2030.[2] By 2035, "the United

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1. United States Census Bureau, *Older People Projected to Outnumber Children for First Time in U.S. History*, https://www.census.gov/newsroom/press-releases/2018/cb18-41-population-projections.html (Mar. 13, 2018, last revised Oct. 8, 2019).

2. Danielle Argoni, *Preparing for an Aging Population*, https://www.aarp.org/livable

States will – for the first time ever – be a country comprised of more older adults than of children."[3]

Aging is inevitable and no one is immune from it or the challenges it brings. Those challenges include an increased risk of diminished capacity. The concept of capacity to make a decision is important because it is the baseline from which we can determine whether a person can legally engage in an act.[4]

Should an individual exhibit any diminishment of capacity, the client is more at risk of elder abuse, called by some to be "the crime of the 21st century."[5] Even if a client or the client's children do not come to an attorney with an elder abuse claim, lawyers should be aware that their clients – young and old – may have conditions that will render the representation more challenging.

Diminished capacity includes several conditions that can limit a client's decision-making and participation abilities, conditions that may be permanent or temporal. The type and scope of diminished capacity should be evaluated so the lawyer can determine how best to proceed in the representation in accordance with the ethical rules described in section II of this article.

Diminished capacity includes a number of conditions, and it may present in different ways. One of those conditions - dementia - impacts between one-third and one-half of people over the age of 85.[6] Dementia is a general decline

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-communities/about/info-2018/aarp-livable-communities-preparing-for-an-aging-nation.html#:~:text=Among%20the%20reasons%20AARP%20has,United%20States%20than%20under%2018.&text=We%20are%20all%2C%20of%20course,will%20reach%2073%20million%20Americans, (last visited July 5, 2020).

3. *Id*.

4. Lawrence A. Frolik and Mary R. Radford, *"Sufficient" Capacity: The Contrasting Capacity Requirements for Different Documents*, 2 NAELA Journal 303, 304 (2006) ("The legal concept of mental capacity, therefore, is the basis for 'when a state legitimately may take action to limit an individual's rights to make decisions about his or her own person or property.'"), https://readingroom.law.gsu.edu/cgi/viewcontent.cgi?article=1009&context=faculty_pub.

5. Kristin Lewis, *The Crime of the 21st Century: Elder Financial Abuse*, PROB. & PROP. Vol. 28 No. 4 (Jul./Aug. 2014).

6. Mary F. Radford, *The Multifaceted Challenges of Recognizing & Representing Clients Whose Capacity is Diminishing* at 8 (2017), https://www.saepc.org/assets/Councils/SouthernArizona-AZ/library/10-18-17%20%20Radford%20-%20Diminished%20Capacity.pdf (hereinafter "Radford, *Multifaceted Challenges*").

in mental ability and can affect a person's decision-making capabilities.[7] Dementia may manifest in several ways, including in cognitive, emotional, or behavioral forms.[8] For example, as described in a American Bar Association and American Psychological Association joint handbook for lawyers, cognitive signs of dementia can include forgetfulness, difficulty communicating, or confusion.[9]

Emotional indicators that a client has dementia might include responses or reactions that are inappropriate for the situation or cannot be explained.[10] Dementia may also be deduced from a client's changed behaviors, including engaging in delusional actions or exhibiting poor hygiene.[11] Though dementia is most often associated with advanced age, younger individuals may exhibit forms of the terminal disease.

Dementia is a form of a continued incapacity – while it can be slowed, it continues inexorably and is largely permanent. Other forms of cognitive decline may not be permanent or total. For example, cognitive decline can also present temporally.[12] Such temporal cognitive decline appears in what is known as Sundowner's Syndrome, a condition in which an individual has sound mental capacity during certain parts of the day but loses those capabilities later in the day.[13]

Partial temporal incapacity can also be exhibited in forms that are not necessarily tied to age. Drug and alcohol abuse, which affects nearly 20 million Americans, also causes individuals to temporarily have a diminished capacity as it pertains to making important legal decisions.[14] Whether permanent incapacity resulting from dementia or temporal incapacity from Sundowner's

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7. *Id*.

8. American Bar Association/American Psychological Association, *Assessment of Older Adults with Diminished Capacity: A Handbook for Lawyers* at 14-18, https://www.apa.org/pi/aging/resources/guides/diminished-capacity.pdf. *Id*. at 22-26 ("Capacity Worksheet for Lawyers").

9. *Id*.

10. *Id*.

11. *Id*.

12. Radford, *Multifaceted Challenges*, *supra* n. 6 at 25.

13. *Id*.

14. American Addiction Centers, *Alcohol and Drug Abuse Statistics*, available at https://americanaddictioncenters.org/rehab-guide/addiction-statistics (last visited July 5, 2020).

Syndrome or substance abuse, lawyers should be aware of the ethical rules that govern how the client-lawyer relationship should proceed under those circumstances.

II. ETHICAL CONSIDERATIONS FOR CLIENTS WITH DIMINISHED CAPACITY

Lawyers should approach each representation with a client assuming that it will be a normal relationship. Each state has its own ethical requirements governing the client-lawyer relationship, although the *American Bar Association's Model Rules of Professional Conduct* serve as a guide for discussing the key components of the client-lawyer relationship that apply in some fashion in most jurisdictions.

A. Maintaining a Normal Client-Lawyer Relationship When a Client has Diminished Capacity

Model Rule 1.14 should be a starting point when lawyers are concerned that their representation of a client who they believe may be impacted by a form of diminished capacity. The rule simply requires that "[w]hen a client's capacity to make adequately considered decisions in connection with a representation is diminished…the lawyer shall, as far as reasonably possible, maintain a normal client-lawyer relationship with the client."[15]

As the comments to Rule 1.14 explain, while client-lawyer relationships are normally founded on the client's ability to make decisions, "a severely incapacitated person may have no power to make legally binding decisions."[16] Notwithstanding the fact that a client may not be able to make certain decisions, the client may "often [have] the ability to understand, deliberate upon, and reach conclusions about matters affecting the client's own well-being."[17] Thus, Model Rule 1.14 seeks to strike a balance between involving the client as much as possible, and as normally as possible, given the circumstances.[18]

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15. MODEL RULES OF PROF'L CONDUCT, R. 1.14(a) (2000).

16. *Id*, at Comment [1].

17. *Id*.

18. *Id*.

Before Model Rule 1.14(a)'s admonition to maintain normalcy applies, an attorney must first determine whether and to what extent the client exhibits diminished capacity. Lawyers are not required to become doctors, though lawyers may consult with medical professionals as they undertake this analysis in appropriate circumstances.[19] Consulting with a professional is not required, however.

The ABA counsels lawyers to consider a number of factors in making their determination that a client has diminished capacity, including by evaluating "the client's ability to articulate reasoning leading to a decision; variability of state of mind and ability to appreciate consequences of a decision; the substantive fairness of a decision; and the consistency of a decision with the known long-term commitments and values of the client."[20]

Lawyers must be careful in making this determination. Clients, -whether or not they have diminished capacity - have the right to make poor decisions and lawyers must not substitute their own judgment for that of their clients.[21]

Maintaining normalcy in the representation might differ depending on the form of incapacity exhibited by the client. For example, if a lawyer believes a client suffers from Sundowner's Syndrome after seeing the client engage in cogent, consistent, and independent decision making during certain times that dissipate at later times, the lawyer should work with the client and ensure that meetings and case-related events are scheduled when the client is most able to meaningfully participate and engage.[22]

What does not differ, however, are the ethical requirements that a lawyer must follow to maintain the normal client-lawyer relationship envisioned

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19. *Id*. at Comment [6] ("In appropriate circumstances, the lawyer may seek guidance from an appropriate diagnostician.").

20. *Id*.

21. *See* ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 404 (1996) ("A client who is making decisions that the lawyer considers to be ill-considered is not necessarily unable to act in his own interest, and the lawyer should not seek protective action merely to protect the client from what the lawyer believes are errors in judgment.").

22. Radford, *Multifaceted Challenges*, *supra* n. 6 at 25. *See also* NAELA, *Aspirational Standards for the Practice of Elder Law and Special Needs Law with Commentaries*, https://www.naela.org/AspirationalStandards (2d ed. 2017) (last visited July 5, 2020) (encouraging attorneys to maintain as normal a relationship as possible, adapting the "interview environment, timing of meetings, communications, and decision making process to maximize the client's ability to understand and participate in light of the client's capacity and circumstances").

under Model Rule 1.14(a). For example, Model Rule 1.2, which addresses authority and control in the client-attorney relationship, mandates that "a lawyer shall abide by a client's decisions concerning the objectives of representation."[23]

To do so, a lawyer must abide by the duty to communicate, which requires that the lawyer "reasonably consult with the client about the means by which the client's objectives are to be accomplished."[24] Communication also includes a duty to "explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation," a responsibility that can be met even when a client has diminished capacity.[25] Finally, lawyers must ensure that they maintain client confidentiality.

Under Model Rule 1.6, a lawyer "shall not reveal information relating to the representation of a client."[26] Confidentiality is a much broader duty than realized by most lawyers – protecting "all information relating to the representation, whatever its source."[27] Confidential information would include that the client is suffering from some form of diminished capacity.[28] Accordingly, Rule 1.14 makes clear that "unless authorized to do so, the lawyer may not disclose" the client's diminished capacity.[29]

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23. MODEL RULES OF PROF'L CONDUCT, R. 1.2(a).

24. MODEL RULES OF PROF'L CONDUCT, R. 1.4(a)(2).

25. MODEL RULES OF PROF'L CONDUCT, R. 1.4(b).

26. MODEL RULES OF PROF'L CONDUCT, R. 1.6(a).

27. *Id*. at Comment [3].

28. MODEL RULES OF PROF'L CONDUCT, R. 1.14(c) ("Information relating to the representation of a client with diminished capacity is protected by Rule 1.6.").

29. MODEL RULES OF PROF'L CONDUCT, R. 1.14, Comment [8].

B. Protective Action When the Normal Client-Attorney Relationship is Impossible

While normalcy can be maintained in many client-lawyer relationships even when the client exhibits signs of diminished capacity, a normal client-lawyer relationship is not always possible. Thus, Model Rule 1.14 provides the lawyer with the ability to "take reasonably necessary protective action" in the event that a client has diminished capacity and a fully normal representation is not possible.[30]

Those protective actions can include:

- seeking the appointment of a representative to take action on behalf of the client as an extreme step; or
- consulting with persons or entities who are in a position to protect the client.[31]

Before taking such drastic measures, the lawyer should have attempted to continue the client-attorney relationship as normal and to take the least restrictive means to protect the client while respecting the client's autonomy and seeking to involve them and their wishes in the representation.[32]

III. RESOURCES FOR LAWYERS REPRESENTING CLIENTS WITH DIMINISHED CAPACITY

This short article has provided a high-level overview of the ethical concerns a lawyer should consider if the client may have some form of

30. MODEL RULES OF PROF'L CONDUCT, R. 1.14(b).

31. *Id*. at Comment [5] ("Such measures could include: consulting with family members, using a reconsideration period to permit clarification or improvement of circumstances, using voluntary surrogate decision-making tools such as durable powers of attorney or consulting with support groups, professional services, adult-protective agencies or other individuals or entities that have the ability to protect the client.").

32. MODEL RULES OF PROF'L CONDUCT, R. 1.14 at Comment [2] ("Even if the person has a legal representative, the lawyer should as far as possible accord the represented person the status of client, particularly in maintaining communication."); *id*. at Comment [5] ("In taking any protective action, the lawyer should be guided by such factors as the wishes and values of the client to the extent known, the client's best interests and the goals of intruding into the client's decision-making autonomy to the least extent feasible, maximizing client capacities and respecting the client's family and social connections.").

diminished capacity. Accordingly, lawyers may wish to consult additional sources before they take any actions that could impact the normal client-lawyer relationship. Here is a non-exhaustive list of further materials that should be of assistance:

1. American Bar Association Center for Professional Responsibility: The ABA maintains substantial resources online via its Center for Professional Responsibility. From model ethics rules to opinion letters providing advice to lawyers with questions on ethics matters, this site provides information for attorneys seeking to study and understand their ethical responsibilities to clients.[33]

2. NAELA Aspirational Standards for the Practice of Elder Law: Drafted by the National Academy of Elder Law Attorneys, the Aspirational Standards for the Practice of Elder Law and Special Needs Law with Commentaries provides attorneys with information "to navigate the many difficult ethical issues that often arise when representing elderly individuals and individuals with special needs."[34] NAELA's work fills in gaps and questions left open under the ABA's Model Rules and provides advice for holistic representation.

3. American Bar Association/American Psychological Association, Assessment of Older Adults with Diminished Capacity: The ABA has a robust set of resources, including seminars and written materials, for lawyers, judges, psychologists, and physicians to assist each professional when they believe that a lawyer's client may be suffering from diminished capacity.[35]

4. American College of Trust and Estate Counsel (ACTEC), Commentaries on the Model Rules of Professional Conduct: ACTEC undertook its own review of the ABA's Model Rules of Professional Conduct to provide guidance relevant to trust and estate counsel, many of whom work with clients who may be exhibiting signs of diminished capacity.[36]

33. *See*, ABA, *Center for Professional Responsibility*, https://www.americanbar.org/groups/professional_responsibility/ (last visited July 5, 2020) ("The Center for Professional Responsibility provides national leadership in developing and interpreting standards and scholarly resources in legal and judicial ethics, professional regulation, professionalism and client protection.").

34. NAELA, *Aspirational Standards for the Practice of Elder Law and Special Needs Law with Commentaries*, available at https://www.naela.org/AspirationalStandards (2d ed. 2017) (last accessed July 5, 2020).

35. ABA, *Capacity Assessment*, https://www.americanbar.org/groups/law_aging/resources/capacity_assessment/ (May 20, 2020) (last visited July 5, 2020).

36. The American College of Trust and Estate Counsel, *Commentaries on the Model Rules of Professional Conduct*, https://www.actec.org/assets/1/6/ACTEC_

5. AARP, Protecting Older Investors: The Challenge of Diminished Capacity: Focused on the entirety of the financial industry, lawyers representing clients in FINRA arbitration proceedings may find AARP's white paper on concerns facing older investors helpful as they both develop their case theory and navigate representing a client who may have diminished capacity.[37]

6. State and City Bar Association Ethics Hotlines: A lawyer concerned about ethical considerations in representing a client with diminished capacity may ethically seek out advice from an expert, including by hiring their own attorney or by contacting their licensing jurisdiction's ethics hotline. Many bar associations maintain a phone number that lawyers licensed in that jurisdiction may call to see the bar authority's free advice on matters of ethical concern.[38]

Commentaries_5th_rev_06_29.pdf (5th Ed. 2016) (last visited July 5, 2020).

37. Naomi Karp, *et al.*, *Protecting Older Investors: The Challenge of Diminished Capacity*, AARP Public Policy Institute (Nov. 2011), https://www.aarp.org/content/dam/aarp/research/public_policy_institute/cons_prot/2011/rr2011-04.pdf (last visited July 5, 2020).

38. *See, e.g.,* The State Bar of California, *Ethics Hotline*, available at http://ethics.calbar.ca.gov/Ethics/Hotline.aspx ("The Ethics Hotline, a confidential research service for attorneys only, helps lawyers identify and analyze their professional responsibilities.") (800-238-4427); State Bar of Georgia, *Ethics & Professionalism*, available at https://www.gabar.org/barrules/ethicsandprofessionalism/ ("Lawyers who would like to discuss an ethics dilemma with a member of the Office of General Counsel staff should contact the Ethics Helpline at 404-527-8741, 800-682-9806 or log in and submit your question by email."); New York City Bar, *Ethics Hotline*, available at http://www.nycbar.org/member-and-career-services/ethics/hotline ("New York lawyers faced with ethical questions regarding their own prospective conduct can reach the Ethics hotline through Customer Service at 212.382.6663."); Virginia State Bar, *Ethics Questions and Opinions*, available at https://www.vsb.org/site/regulation/ethics ("Any member of the bar may seek informal ethics or unauthorized practice of law advice by calling the Ethics Hotline at (804) 775-0564."); State Bar of Arizona*, Ethics Hotline*, available at http://www.azbar.org/ethics/ethicshotline/ ("Ethics Hotline Number: 602.340.7284"); Pennsylvania Bar Association; *Ethics Hotline*, available at http://www.pabar.org/public/Membership/ethics.asp ("The Ethics Hotline provides free advisory opinions to PBA members based upon a review of a member's prospective conduct by members of the PBA Committee on Legal Ethics and Professional Responsibility .... The Ethics hotline can be reached at (800) 932-0311, ext. 2214."); State Bar of Texas, *Toll-Free Ethics Helpline for Lawyers*, available at https://www.texasbar.com/Content/NavigationMenu/ForLawyers/GrievanceandEthics/Toll_Free_Ethics_Helpline_for_Lawyers/default.htm (800.532.3947); State Bar of Michigan*, Ethics Article: Ethics Hotline - Frequently Asked Questions*, available at

CONCLUSION

Representing clients exhibiting forms of diminished capacity – either total, partial, or temporal – is difficult. If a lawyer suspects that a client has diminished capacity, the lawyer should start by looking to the ethical rules in the jurisdiction where the lawyer is licensed.

Core principles of client-centered representation, including communication, confidentiality, and allowing the client to direct the representation, should guide the lawyer's next steps. As much as possible, lawyers should strive to maintain normalcy in the client-lawyer relationship and allow the client to meaningfully participate in the representation.

In accommodating the most normal relationship that can be achieved, lawyers should not, however, be afraid to seek the help of others so long as core client-lawyer ethical responsibilities are not violated.

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https://www.michbar.org/opinions/ethics/articles/july98 ("The Ethics Hotline at the State Bar of Michigan (877) 558-4760 receives approximately 20 calls per day from Michigan lawyers seeking guidance on a full array of ethics issues from lawyers."); The Florida Bar, *Ethics Hotline*, available at https://www.floridabar.org/ethics/ethotline/ ((800) 235-8619).

WOMEN IN THE PROFESSION- TELL ME I CAN'T

Sara Hanley, Esq.[1]

I. Introduction

The times they are a-changin',[2] and long gone are the days when all attorneys were white, middle-aged men. These days, law schools often have more female than male students and are populated by people of various ethnicities, religions, and cultures. So why is it that when you begin to practice, the legal workplace is predominately male? Even now, well over a decade into my career, I am more often than not the only female attorney in the room. Why is that?

Current research strongly suggests that diverse workgroups achieve more and are more dedicated, innovative and trustworthy.[3] Cohorts consisting of both men and women have higher collective intelligence, which advances the performance of both the group and the individual.[4] Diverse workgroups also produce enhanced financial performance results due to their improved ability to consider a broader range of alternatives, make wiser decisions, and solve problems.[5] So why is the experience of practicing law so different for women compared to men? And, where are all the women?

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1. Sara Hanley represents investors nationwide who have lost their savings and retirement funds as a result of their brokerage accounts being mishandled. Attorney Hanley is the founder of Hanley Law. The firm represents investors in FINRA arbitrations and securities related class actions. www.finralawyer.org. The author thanks Melanie Cherdack for her editorial comments and support of this article.

2. Bob Dylan, *The Times They Are A-Changin'*, *on* THE TIMES THEY ARE A-CHANGIN' (Columbia Records 1964).

3. Joan C. Williams, Marina Multhaup, Su Li, and Rachel Korn, *You Can't Change What You Can't See, Interrupting Racial and Gender Bias in the Legal Profession (Executive Summary),* A.B.A. & MINORITY CORPORATE COUNSEL ASSOCIATION, at 12 (June 28, 2018), https://www.americanbar.org/content/dam/aba/administrative/women/you-cant-change-what-you-cant-see-print.pdf.

4. *Id.*

5. *Id.*

II. We Know the Problems All Too Well

A. Implicit Bias

Female attorneys deal with the double standard of being perceived negatively as "aggressive or abrasive," while the same behavior is described as "confident" in men.[6] Women's self-reflection and internalization of the appearance of their everyday behavior presents a common conundrum because women's behavior, good or bad, is often a topic of conversation while a male peer's similar behavior typically is not.

In a recent survey by the American Bar Association (ABA), women reported experiencing that they have to go "above and beyond" to achieve the same recognition and respect as their male colleagues.[7] Women reported experiencing greater levels of bias than white men regarding equal opportunity in getting hired, receiving fair performance evaluations, mentoring opportunities, receiving high-quality assignments, accessing networking opportunities, fair pay, and promotions.[8] In fact, gender bias was found in all seven of these attorney workplace areas.[9]

Implicit bias is common, but the good news is that it can be interrupted. Stereotypes are the cornerstones for implicit bias.[10] Stereotypical thoughts are automatic and people cannot stop their brains from making reflexive assumptions.[11] However, the application of the stereotype and whether or not individuals act on the stereotype or implicit bias can be controlled.[12]

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6. Kim Dougherty & Sofia Bruera, *The Power of Gender Equity*, TRIAL 34, 36 (March 2014), http://ntlsummit.com/wp-content/uploads/2015/01/1-18-15-305-pm-kimberly-dougherty.pdf.

7. Williams, et al., *supra* note 3, at 8. In April 2016, the ABA's Commission on Women in the Profession, the Minority Corporate Counsel Association, and the Center for WorkLife Law at the University of California, Hastings College of the Law launched a survey seeking to understand in-house and law firm lawyers' experiences of bias in the workplace: 2,827 respondents completed the survey, and 525 respondents included comments. *Id.* at 7.

8. *Id.*

9. *Id.* at 8.

10. *Id.* at 10.

11. *Id.*

12. *Id.*

B. Why so Few Women?

Statistics evidence that women in large law firms have far less access than men to the building blocks that lead to success.[13] When surveyed, many experienced female lawyers reported that, due to their gender, they were significantly more likely than their male peers to be overlooked for advancement, denied a raise or bonus, experience implicit biases, subjected to double standards, victimized by sexual harassment, and wrongfully perceived as less committed to their careers.[14] Not surprisingly, senior female lawyers perceive their firm's commitment to women's issues in the workplace underwhelming in areas such as advocating for gender equality, advancing women into equity partnerships, actively promoting women into leadership roles, and remaining committed to retaining experienced female lawyers.[15]

The lack of female partners and equity partners may stem from a lack of women in the workforce pipeline because historically there were fewer female attorneys or maybe it is due to a continuing failure to recognize and promote women candidates.[16] Alternatively, it could be that fewer women are willing to take on greater responsibilities because male partners are paid on average 27% more than female partners.[17] The good news is that these statistics are bound to change. Overall, the number of qualified women is growing in comparison to men.[18] In 2016, for the first time ever in the U.S., women made up the majority of law students.[19] Today, in the U.S., women make up 51.3

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13. Roberta D. Liebenberg and Stephanie A. Scharf, *Walking Out the Door, The Facts, Figures, and Future of Experienced Women Lawyers in Private Practice*, A.B.A., at ii(2019), https://www.americanbar.org/content/dam/aba/administrative/women/walkoutdoor_online_042320.pdf.

14. *Id.*

15. *Id.*

16. *Id.*

17. A.B.A. COMMISSION ON WOMEN IN THE PROFESSION, *A Current Glance at Women in the Law*, at 6 (April 2019), https://www.americanbar.org/content/dam/aba/administrative/women/current_glance_2019.pdf.

18. *Id.* In 2016, for the first time ever in the US, women made up the majority of US law students. In 2019, in the US, women make up 51.3 percent of US law students. *Id.* at 4.

19. *Id.*

percent of all law students.[20] Achieving gender neutrality in the practice of law is more than just a moral obligation. Any law firm that wishes to remain competitive in the marketplace cannot afford to leave 50% of its talent at the door.[21]

C. The Higher Up You Go, the Less Women There Are

Over the past 20 years, women and men have entered law firms as first-year associates in approximately equal numbers.[22] However, by the time women arrive at the most senior leadership levels – non-equity and equity partners – they represent only 29% and 17% of their peers, respectively.[23] It is clear that female lawyers, on average, do not advance along the same career trajectory as men.[24] Unfortunately, while there is an assumption that the gender gap predominates during a female attorney's early years in practice, the fact is that the gender gap continues and even widens at the partnership level.[25] This is a major contributing factor in the disproportionately high rate of attrition of senior female attorneys.[26] A recent National Association for Law Placement report concluded: "The percentage of partners who are women or minorities has increased at least some every year, but the partnership ranks remain overwhelmingly white and male."[27] Other studies have found that this gender gap in the highest levels of practice adversely impacts law firm

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20. *Id.*

21. Liebenberg & Scharf, *supra* note 13, at iii.

22. A.B.A. COMMISSION ON WOMEN IN THE PROFESSION, *The Grit Project Program Toolkit: Using Grit and Growth Mindset to Advance Women in the Law* (2014), https://www.americanbar.org/content/dam/aba/administrative/women/grit_toolkit_brochure.pdf.

23. *Id.*

24. Liebenberg & Scharf, *supra* note 13, at 2.

25. *Id.*

26. *Id.*

27. *Id.* (*citing* NATIONAL ASSOCIATION FOR LAW PLACEMENT, *Women and Minorities at Law Firms: What Has Changed and What Has Not in the Past 25 Years?* (February 2018), https://www.nalp.org/0218research).

finances, client relationships, the ability to recruit new business, and a firm's ability to retain the best lawyers in the profession.[28]

Experienced female lawyers are much more likely to report harmful work experiences that resulted simply because of their gender than men.[29] A lack of communication and clarity exists when it comes to female attorneys' opportunities for advancement, recognition in the firm and various leadership positions.[30] Female attorneys are considerably more likely than their male peers to report, due to their gender, that they have been mistaken for a lower level employee; disparaged by demeaning comments, stories, or jokes; divested of business development opportunities; perceived as less committed to her career; overlooked for an advancement; denied pay increase or bonus; felt treated as a token representative for diversity; lacked mentor opportunities; and/or missed a desirable assignment.[31] Such serious gender related issues are striking and alarming.[32] The fatal combination of the gender disparity on these vital building blocks to success explains much about why women are not advancing in the legal profession at the same rate as men.[33] Demeaning communication, unwanted sexual advances, gender bias and double standards burden women practicing at all levels, which takes a significant toll on women's satisfaction in their professional life and can ultimately serve as the reasons why they leave the practice of law.

D. Sexual Harassment Remains Problematic

Without question the one area in which women's experience in the profession is drastically different from their male counterparts' experience is the much greater extent to which women experience sexual harassment.[34] It is important to understand the common workplace abuses, including non-sexual

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28. *Id.* (*citing* MCKINSEY & CO., *Why Diversity Matters* (2015); Marcus Noland, Tyler Moran, and Barbara Kotschwar, *Is Gender Diversity Profitable? Evidence From a Global Survey*, THE PETERSON INST. FOR INT'L ECON. (Feb. 2016)).

29. *Id.* at 7.

30. *Id.*

31. *Id.* at 7-8.

32. *Id.* at 8.

33. *Id.*

34. *Id*.

abusive behavior, and to introduce appropriate protections. According to the ABA, thirty percent or more female lawyers have suffered some form of sexual harassment and bullying in the workplace, and at law firms that percentage is likely greater.[35] The persistence of sex-based harassment in the legal profession has profound impacts on the physical and emotional well-being of female lawyers resulting in the decreased job satisfaction and disillusionment with the legal profession.[36]

The Equal Employment Opportunity Commission (EEOC) states that "harassment not involving sexual activity or language may also give rise to Title VII liability…if it is 'sufficiently patterned or pervasive' and directed at employees because of their sex," and that the employer may be vicariously liable for such harassment.[37] The laws against misconduct apply to supervisors, co-workers, peers, clients, judges, professors, students and vendors.[38] Abusive behaviors are defined to include demeaning, condescending or sexualized comments or jokes.[39] Increasingly, sex-based harassment in the workplace has become more nuanced and subtle and is demonstrated in ways such as interruptions or dismissive remarks, comments on appearance, or indirect intimidation.[40] The actions that constitute legally actionable harassment are often situational and fact determinative.[41] To reach the goal of preventing and eliminating sex-based harassment from the legal profession, firms must enact and enforce uniform policies that develop a zero tolerance for harassment.[42] The ABA recently amended Model Rule of

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35. A.B.A., *The Shameful Truth: Sexual Harassment in the Legal Profession* (May 23, 2018), https://www.americanbar.org/groups/crsj/events_cle/program-archive/the-shameful-truth/ (last visited Sept. 9, 2020).

36. Aditi Kumar, *Professional Ethics in the #MeToo Era: A Growing Awareness of Sexual Harassment*, A.B.A. EMP. BENEFITS COMMITTEE NEWSL. (March 4, 2019), https://www.americanbar.org/groups/labor_law/publications/ebc_news_archive/spring-2019-issue/professional-ethics-in-metoo-era/ (last visited Sept. 9, 2020).

37. A.B.A. COMMISSION ON WOMEN IN THE PROFESSION, *The Legal Framework for Sex-Based Harassment and Bullying*, at 16 (2018), https://www.americanbar.org/content/dam/aba/events/women/HandoutMaterials.authcheckdam.pdf.

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.* at 17.

42. *Id.*

Professional Conduct 8.4(g) to state that "professional misconduct" includes any "[c]onduct that the lawyer knows or reasonably should know is harassment or discrimination on the basis of …sex,…sexual orientation, gender identity, [or] marital status…in conduct related to the practice of law."[43]

Lawyers and law firms should be aware of the inconspicuous ways sex-based harassment often manifests and becomes normalized.[44] Gender bullying and inappropriate professional behavior is so pervasive in the workplace that is often overlooked, but it is a precursor to actionable forms of sex-based harassment that should not be ignored.[45] A significant number of female attorneys report that opposing counsel, judges, and other court officials mistake them to be secretaries or paralegals.[46] Similarly, there are many unconscious behaviors that perpetuate stereotypes and sex-based treatment that individuals fail to recognize with their own behaviors and the culture of their professional organizations.[47] It is imperative that law firm and legal organization leaders implement a common sense approach and enforceable policies that allow women to report sexual harassment, protect them from retaliation, and punish the perpetrator of the misconduct. Inappropriate sex-based workplace conduct is harmful to employees, and it tarnishes the legal professional as a whole; yet, unfortunately, it has long been generally socially acceptable. The positive news is that cultural norms of sexism and sex-based harassment are slowly dying, and it is no longer as much of an acceptable societal convention to harass women in the workplace. It is time for the legal profession to send a strong message, as we have seen in other industries, that sexual harassment will not be tolerated.

E. Assignment Allocations and Family Responsibilities

Law firms, just like any other workplace, have both high profile assignments, or "glamour work," that is career enhancing and "office housework," or low-profile assignments, that are beneficial to the organization but not to the individual's career.[48] Research shows that women do more

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43. *Id.*; *see* MODEL RULES OF PROF'L CONDUCT r. 8.4(g) (AM. BAR ASS'N 2016).

44. *Id.* at 17-18.

45. *Id*. at 17.

46. *Id.* at 16.

47. *Id*. at 17-18.

48. Williams, et al., *supra* note 3, at 18.

"office housework" than men, such as administrative tasks and providing emotional support.[49] The overallocation of office work and under allocation of glamour work to women across the legal profession is a key reason why leadership in the legal field is still male dominated.[50] Women often report less access to desirable assignments than white men.[51] In law firms that are often driven by billable hours, when a female lawyer becomes overburdened with office housework, it decreases the amount of time she can dedicate to billable hours, which in turn hurts her compensation and her career.[52]

Top tier diversity can only be achieved when diversity exists at all levels of the firm and men and women have equal access to glamour assignments that allow them take risks and develop meaningful skills.[53] When female attorneys continue to be tasked with an uneven distribution of low-profile assignments, they often become dissatisfied with their position and begin to search for new opportunities outside of the practice of law.[54] Law firms must address the inequality in assignments if they want to tap the full potential of their available workforce.[55] A level playing field requires that law firms allocate both career-enhancing assignments and the less high profile and back-office work equitably.[56] Women must interrupt any bias in the allocation of work assignments. To interrupt this gender bias, women must affirmatively announce their desire to be assigned the glamour work and consciously advocate for those tasks. Likewise, women who are being assigned an inordinate amount of low-profile assignments should suggest that the office housework assignments be distributed more evenly amongst all of the firms' attorneys at their level.

As securities attorney Jenice Malecki wrote, "in the legal profession where billable hours and client interaction are vastly important to promotions and success, equal work at home is a necessary component for women to achieve

49. *Id.*

50. *Id.*

51. *Id.*

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.*

top leadership positions and equal pay opportunities."[57] She further concludes that arguments have been made that women leave the workforce to rear children, but we need to ask ourselves whether they leave because they earn less than their spouse.[58] When it comes to law firm compensation, many female lawyers believe that the compensation policies are "rigged" against them.[59] Families are often forced to make financial decisions that are not always best for the individual professional involved, but if equal work resulted in equal pay for men and women, at least some financial decision making would be based on more even grounds.

III. Let's Focus on the Solutions

A. Grit and Growth Mindset

As a profession, what can we do to really move the needle on equalizing the workplace experiences of men and women in the legal profession? Historically, there have been relatively few studies to identify the obstacles that contribute to the gender gap in the leadership levels of the legal profession.[60] Until recently, there has been little known about what common characteristics the women who make it to equity and non-equity positions in the top ranks of law firms have in common.[61] In 2012, a crucial study undertook this vital research.[62] The results of the research identified two main significant traits among highly successful female attorneys: grit and growth mindset.[63] The best news, is that these are factors which female lawyers control.[64] Grit is defined as "perseverance and passion for long-term goals."[65] "Growth mindset" is defined as "the belief that one's most basic abilities can

57. Jenice Malecki, *Diversity in Arbitration: Where is Everyone?*, PIABA Bar Association Annual Meeting (Oct. 2019).

58. *Id.*

59. Liebenberg & Scharf, *supra* note 13.

60. The Grit Project*, supra* note 22.

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.*

65. *Id.*

be developed through dedication and hard work- brains and talent are just the starting point."[66] The growth mindset gives rise to a dedication to learning and deep resilience that is necessary for unlimited accomplishment.[67] Grit paired with a growth mindset were found by researchers to be the keys to female attorneys' success.[68] These tools aid highly-successful female attorneys in handling and ultimately overcoming difficult situations.[69]

Grit has been proven to predict achievement and can exceed other metrics to which law firm recruiting departments commonly look, such as GPA and class rank in law school. [70] The research on grit has shown that individuals who inherently have more grit tend to work harder and longer hours than their peers and are more likely to engage in intentional efforts to improve their abilities.[71] Grittier individuals are more likely to stay committed to goals and not get distracted by short term concerns or desires.[72] Having grit is especially imperative in difficult contexts.[73]

When it comes to mindset, individuals with a fixed mindset believe that their strengths are predetermined, whereas people with a growth mindset see their abilities as adaptable and capable of growth through determination and dedication.[74] A recent study of female attorneys in AmLaw 200 firms evidenced a strong, statistically important relationship between grit and success for women in BigLaw.[75] The research implies that grit is a precursor to success rather than an outcome of it.[76] Researchers have also determined that many affluent female attorneys exhibit growth mindset characteristics and

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66. Alli Gerkman and Milana L. Hogan, *Accelerating Talent, Grit and Growth Mindset Fuels Lawyers' Success Throughout Their Careers*, 90 NY ST. B. ASS'N J. 49 (Dec. 2018), https://www.americanbar.org/content/dam/aba/administrative/women/nysba_combination.pdf.

67. *Id.*

68. The Grit Project, *supra* note 22.

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

depend greatly on these skills to navigate adversity and the often times overwhelming demands in the practice of law.[77] The most advantageous benefit of this new research is that the grit and growth mindset is in the control of the individual.[78] These traits, which can at least partially be learned, lead to the continued success of more female attorneys.

The grit and growth mindset is a crucial trait for both seasoned professionals and recent law school graduates.[79] The traits attributed to grit are: diligence; flexibility and adaptability regarding unforeseen, ambiguous or changing circumstances; resilience after a set-back; passion for the work; ability to regulate emotions and demonstrate self-control; set goals and make a plan to meet them; and taking ownership.[80] Growth mindset traits include enjoying overcoming challenges; having an internalized commitment to developing towards excellence; having a strong work ethic and putting forth best effort; positivity; and showing initiative.[81] These traits are critical to success for female lawyers, whether they are in their first year of practice or have been practicing law for decades.[82] The research developed as part of the grit and growth project applies commonly to a broad range of legal settings, including success in law firms of all sizes, solo practitioners, government, not-for-profits and in-house positions.[83] Ultimately, the findings from the research of the ABA Commission on Women in the Profession determined that demonstrations of grit and growth mindset have a strong impact on success of female lawyers across all practice settings.[84]

It has been argued that it's not smarts, talent, looks, luck or chance that separates the risers from the fallers –it's grit.[85] The modern term "grit" was coined in 2013 by Angela Duckworth, a psychology professor at the University

77. *Id.*

78. *Id.*

79. Gerkman & Hogan, *supra* note 66, at 49.

80. *Id.* at 52.

81. *Id.*

82. *Id.* at 49.

83. *Id.* at 50.

84. *Id.*

85. Kristen Hamilton, *Why Grit Matters in the Workplace*, WORLD ECONOMIC FORUM (2014), https://www.weforum.org/agenda/2014/10/grit-iq-workplace-persistence-failure/ (last visited Aug. 28, 2020).

of Pennsylvania.[86] Duckworth described grit as the "quality of being able to sustain your passions, and also work really hard at them, over really disappointingly long periods of time."[87] She taught that individuals with grit are people who can overcome stress and use failure as a means to achieve their ultimate goals.[88] Grit has also been described as an "indomitable spirit."[89] Grit is resilience and going after what you want with everything you've got.[90] Grit means striving for progress and never yielding in pursuit of your passions, whether or not the legal arena is fair and welcoming to female attorneys, which most conclude it is not. Sometimes to make progress you have to get comfortable in the uncomfortable and successful female lawyers know this all too well.

B. Check Yourself

Cultural expectations are set by leaders. It has been said that "privilege is invisible to those who have it."[91] It is no secret that men hold the majority of the leadership positions in the law. So, as men, what can you do to ensure that you help reverse the course to safeguard your spouses, daughters and granddaughters from facing the same challenges that your current colleagues and the women paving the way before them face? It is imperative that individuals within certain demographic groups become cognizant of their own privileges. Recognizing one's "privilege" is not easy, but it is important for the betterment of our profession and for the goal of achieving fair, efficient, and effective legal forums.[92]

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86. *Id.*; *see* Duckworth, A.L., Peterson, C., Matthews, M.D. & Kelly, D.R., *Grit: Perseverance and Passion For Long-Term Goals*, 92(6) J PERS SOC PSYCHOL. 1087-1101, 1087 (2007).

87. Hamilton, *supra* note 87.

88. *Id.*

89. *Id.*

90. *Id.*

91. Fiona Smith, *Privilege is Invisible To Those Who Have It: Engaging Men in Workplace Equality*, THE GUARDIAN (June 7, 2016), https://www.theguardian.com/sustainable-business/2016/jun/08/workplace-gender-equality-invisible-privilege (last visited Aug. 28. 2020).

92. Malecki, *supra* note 57.

For the advancement of the profession, men must be more open to discussing female experiences in the workplace.[93] Societal "black boxes" only hinder the necessary progress in resolving the underlying issues that contribute to the bigger problems of sexism.[94] Above all, destructive implicit biases, sexual harassment, workplace inequality, and other inequity issues should no longer be silenced.[95] All people, men and women, need to have the resolve to address issues when they occur.[96] Professionals must do the right thing and not hide behind the societal norm that it is acceptable to treat certain people badly or disparately because of their gender or race.

Male attorneys have a responsibility to actively promote gender equality by providing support, encouragement and mentorship to female attorneys.[97] Men in the legal profession should also actively seek the recommendations and opinions of their female colleagues to encourage diverse viewpoints.[98] Law firms and society as a whole can only benefit from having female attorneys active within the legal community.[99]

IV. What Legal Organizations Can do to Help

As professionals and members of professional organizations, we must encourage underrepresented attorneys to be promoted and to have the opportunities to contribute towards an upstanding, diverse, fair, and efficient legal system.[100] Every organization has a culture defined by its policies, practices, expectations, unwritten rules, implicit and explicit biases, and professional goals. This culture can have either a positive or negative consequence for gender parity. If we want our legal organizations to thrive and improve, then we need some baseline protections in place to support members who may experience harassment or sexual harassment. There must be a zero-tolerance policy. Decorum and respect towards the other members

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*

97. Dougherty & Bruera, *supra* note 7, at 38.

98. Malecki, *supra* note 57.

99. *Id.*

100. *Id.*

of the organization should be non-negotiable. Gender neutrality in the practice of law and in professional organizations should be the norm and not the exception.

We need a culture shift if we are going to attract gender neutral talent to our profession and legal organizations. If we want the "best of the best," we cannot exclude half of the population from our search. A subtle shift in the tone of conversations and a general real world recognition that not all of our professional colleagues will have the same gender, race or religion is the simple baseline approach that would move our profession into a dramatically new era. Our profession is conducted in court rooms and hearing rooms, not in locker rooms. Our professional abilities as lawyers are not gender specific.

Our clients are often women and our practices would benefit from more female attorneys to meet the needs of our diverse clientele. At the end of the day, all professionals want to be recognized and appreciated for their work and contributions to the legal system. Female attorneys are not asking for anything more than a fair opportunity to sink or swim. It is important for each of us to do what we can to better our legal organizations and the practice of law. Acting with decorum and professionalism to all of our colleagues would be a big step in the right direction. Be professional in all that you do.

Rules of Conduct and Professionalism must be enforced in the legal profession and in our professional organizations. Those unfortunate enough to be the victim of the harassment or bad conduct of another member should have a place to report the bad conduct without fear of ridicule and professional embarrassment. Organizations need to make certain that their harassment policies are clear, well known, and applied equally. The willingness of legal organizations to modify their behaviors to achieve gender parity ultimately depends on how much talent the organization wants to attract and retain.

V. Conclusion

The increasing number of diversity and women's initiatives are encouraging, but we still have a ways to go to change legal culture. Double standards regarding behavioral expectations, lack of advancement opportunities and lack of recognition remain pervasive. Making meaningful advancements towards gender parity in the legal profession is no small feat. The impediments that female attorneys face have nothing to do with their qualifications, talent, or ambition, but are created by implicit bias, stereotypes and sexual harassment, all of which are unacceptably pervasive in the legal profession.[101] Simply due to their gender, women endure demeaning comments, are deprived opportunities, are overlooked for advancement, and are often excluded. Until laws and societal norms change, the only control we have as women and men who care about this issue is to change our own behavior. As women, we can change our outlooks, expectations, approaches, and work hard every day to level the playing field. Most importantly, we must speak up for ourselves and others when we are presented with unacceptable behaviors. Silence is consent and there will be no positive change if issues are not confronted. Gender parity is advancing in the legal profession, but traditions, cultures and behaviors only change when there is a strong commitment to making the change and competent actions create a culture of respect and accountability.

101. Liebenberg & Scharf, *supra* note 13, at ii.

RECENT ARBITRATION AWARDS
GRANTING EXPUNGEMENT

Christopher J. Gray

As of this writing, FINRA arbitration hearings across the country have been administratively postponed for a period of over six months - from March 18, 2020 until October 2, 2020 - due to safety concerns surrounding the COVID-19 pandemic. In these circumstances, with no new in-person hearings going forward, there are no recent notable arbitration awards of note to address in these pages. However, given this pause in the issuance of new awards, your PIABA Bar Journal editors have decided to use this issue to address a pernicious and growing epidemic in our own practice: unwarranted expungements.

Those that are familiar with the history of PIABA's response to the expungement issue will know that our bar association has highlighted this problem on multiple previous occasions, initially publishing the much-publicized study released on September 24, 2007[1] that found, *inter alia*, that expungements were granted in 98.4% of cases in which the relief was requested. Six years later, on October 16, 2013, PIABA released a second study finding that expungement was granted in 96.9% of cases filed between May 18, 2009 and December 21, 2011.[2] The passage of another six years did nothing to improve circumstances, and on October 15, 2019, the PIABA Foundation issued a study highlighting ongoing problems with the expungement process and chronicling the proliferation of arbitration cases filed solely for the purposes of obtaining expungement- sometimes many years after the underlying arbitration proceeding brought by the customer was concluded. The ongoing issue of expungements of customer complaints has also been the subject of other learned analysis, including a recent paper by two law professors showing via statistical analysis that "brokers with prior

1. Accessible at https://piaba.org/sites/default/files/newsroom/2007-09/September%2024%2C%202007%20including%20Expungement%20Study.pdf.

2. Accessible at https://piaba.org/sites/default/files/newsroom/2013-10/PIABA%20Expungement%20Study.pdf.

expungements are 3.3 times as likely to engage in new misconduct as the average broker."[3]

Some brief background concerning expungement generally: expungement is addressed in FINRA Rule 2080 (formerly NASD Rule 2130) and involves purging reference to customer complaints and arbitration claims from a registered representative's FINRA BrokerCheck report.

A party seeking expungement in an arbitration proceeding may ask for this relief in his or her Statement of Answer in the underlying customer case, or may file a separate arbitration case at a later date for the sole purpose of seeking expungement. To grant expungement, an arbitration panel must hold a recorded telephonic or in-person hearing, and must make an affirmative finding that the subject matter of the claim (the customer complaint(s) or arbitration(s)) sought to be expunged meet one or more of the three standards specified in Rule 2080. *See* FINRA Code of Arbitration Procedure Rules 12805 and 13805 and Regulatory Notice 08-79. The three Rule 2080 findings, any of which would support expungement under the rule, are as follows:

1. The claim, allegation, or information is factually impossible or clearly erroneous.
2. The registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds.
3. The claim, allegation, or information is false.[4]

After the arbitrators make these findings and enter an award, the registered representative must then file a separate court proceeding to confirm the arbitration award pursuant to the Federal Arbitration Act, 9 U.S.C. § 9. FINRA has the right to appear in the confirmation proceeding in court and oppose confirmation if FINRA believes that the arbitrators' Rule 2080 findings are erroneous.

The current rule scheme replaced a former practice under which parties frequently stipulated to an award of expungement in connection with settlement agreements, which award arbitrators frequently would enter in a form agreed to by the parties without analyzing the underlying facts of the customer claim, or making any affirmative factual findings. In announcing the framework of the current rule scheme, FINRA's predecessor National

3. *See* Honigsberg and Jacob, *Deleting Misconduct: The Expungement of BrokerCheck Records* (March 2020), accessible at https://law.stanford.edu/wp-content/uploads/2020/03/Honigsberg_and_Jacob__2020_SSRN.pdf.

4. https://www.finra.org/rules-guidance/rulebooks/finra-rules/2080.

Association of Securities Dealers ("NASD") described the genesis of the rule change as follows:

> NASD began considering how to craft an approach to expungement that would allow NASD, in its capacity as an SRO and as operator of the CRD system, effectively to challenge expungement directives that might diminish or impair the integrity of the system and to ensure the maintenance of essential information for regulators and investors.

See Notice to Members 04-16, accessible at https://www.finra.org/rules-guidance/notices/04-16.

Despite the ostensibly noble purposes of the rule change, any remaining virtue in the current expungement process has succumbed to sharp practices, with certain legal practitioners, for example, filing scores of standalone expungement cases (for affordable flat fees) to wipe clean even decades-old customer complaints or, in some cases, to wipe clean multiple customer complaints and arbitrations via a single expungement case.[5]

Further, as illustrated by the awards below, FINRA panels frequently make findings that a customer's allegations were "false" and grant expungement, despite the case being settled for a substantial sum, representing a sizeable portion of the damages sought, and that would have represented a good result had claimant won the case on the merits.

Another disturbing trend is cases in which respondents' counsel trumpet language in subscription paperwork or a disclosure document that contradicts claimants' allegations that an investment was solicited via misrepresentations and omissions of fact. Respondents then argue that since the facts the claimant says were omitted are contained in the offering documents, the claim therefore must be "false", and spoon-feed arbitration panels findings of fact based on the subscription documents that appear to support a finding of falsity.

These rubber-stamp findings of falsity ignore the well-established principle that providing a customer with a prospectus or private placement memorandum containing disclosures cannot cure an otherwise misleading oral sales presentation. *See* FINRA Notice to Members 05-59 (2005) and authorities cited therein, accessible at https://www.finra.org/rules-guidance /notices/05-59. Just because a prospectus or other disclosure document was provided clearly does not mean that a claimant's claims are false or lack merit. Indeed, many sales practice cases that are won at hearing based on the weight

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5. *See* October 15, 2019 press release announcing PIABA Foundation study, accessible at https://www.businesswire.com/news/home/20191015005817/en/PIABAFoundation-Study-Warns-Out-of-Control-FINRA-Broker.

of disputed testimony concerning a misleading oral sales presentation could nonetheless be characterized as "false" claims under the twisted reasoning of what amount to rubber-stamped expungement awards.

The following specific awards represent extreme cases in which expungements were granted in egregious circumstances, but nonetheless exemplify an infectious problem that has continued to proliferate during the approximately 15 years since the current expungement rule regime became effective.

Frank Meyers, individually; and Frank Meyers on behalf of the Frank Meyers Family Trust; Kepner Plastics Profit Sharing Plan; Meyers FLP; and Meryl Lee on behalf of the Calle Mayor Trust (Claimants) v. Morgan Stanley (Respondent)

Case No. 16-03671

Los Angeles, California

Hearing Dates: Settled on or about April 20, 2018

Expungement Date: October 5, 2018

Counsel:

Counsel for Claimants: Robert J. Girard II, Esq., Girard Bengali, APC, Los Angeles, California.

Counsel for Respondent: Neal S. Robb, Esq. and Melanie L. Ronen, Esq., Keesal, Young & Logan, Long Beach, California.

Arbitration Panel

Robert E. Jenks, Public Arbitrator, Presiding Chairperson

Holly Banafsheh, Public Arbitrator

Owen Frances, Public Arbitrator

Investments at Issue:

Claimants' investment in stock in Russian companies, including Gazprom, Sberbank, Market Vectors and Kopernik.

Claimants' Claims:

Causes of Action in Statement of Claim:

(1) Violations of state and federal securities laws and FINRA/SEC rules;

(2) Breach of fiduciary duty;

(3) Unsuitable recommendations and investment strategy;

(4) Failure to supervise and control;

(5) Breach of written contract;

(6) Constructive fraud, common law fraud and fraud by material misrepresentations/omissions;

(7) Unjust enrichment;

(8) Elder financial abuse; and
(9) *Respondeat superior*.

Relief Requested:

(1) General and compensatory damages in an amount not less than $975,000.00;
(2) Lost opportunity cost;
(3) Rescission of all unsuitable investments Respondent recommended;
(4) Disgorgement of all commissions and fees paid to Respondent for the life of Claimants' accounts;
(5) Costs of proceedings;
(6) Punitive damages;
(7) Interest at the legal rate on all sums recovered;
(8) Attorneys' fees and costs; and
(9) Such other and further relief as the Panel deems just and appropriate.

Settlement Amount: $275,000.00
Expungement: Granted over Claimant's Objections during Hearing
Analysis:

This award represents one of the most egregious expungements we have reviewed, in light of the $275,000.00 settlement payment to an elderly investor, reportedly age 92 at relevant times. Despite this substantial payment, the Panel nonetheless made an affirmative finding that "the claim, allegation, or information is false." In fact, the Panel, in the actual Award, went as far as to claim that:

> The Panel noted that the settlement was not conditioned on Claimants not opposing the requests for expungement. The Panel also noted that the Unnamed Parties did not contribute to the settlement amount. The Panel further noted that while the settlement amount of $275,000.00 (paid by Respondent) is a significant amount, the Panel accepts it as a business decision and further finds that the Unnamed Parties had no say in the settlement.

This finding is of course a truism, in that every settlement is a "business decision" for the broker dealer, and payments by a broker dealer on behalf of a registered representative are common. In this matter, despite avoiding having to pay for their alleged misdeeds, the named registered representatives apparently managed to turn the fact pattern to their advantage by spinning the broker dealer's payment of the settlement sum as meaning that they had "no say in the settlement."

James Patrick Shawver (Claimant) v. Independent Financial Group, LLC. and Merrill Lynch Pierce Fenner & Smith Inc. (Respondents)
Case No. 18-02665
Boca Raton, Florida
Hearing Dates: Underlying Matter Settled on or around May 18, 2018
Expungement Date: February 6, 2019
Counsel:

Counsel for Claimant: Harris Freedman, Esq., HLBS Law, Westminster, Colorado.

Counsel for Respondents: For Respondent Independent Financial Group, LLC: Sarah J. Kreisman, Chief Legal Counsel and VP, Compliance, Independent Financial Group, LLC, San Diego, California.

For Respondent Merrill Lynch Pierce Fenner & Smith Inc.: Joel M. Everest, Esq., Bressler, Amery & Ross, P.C., Birmingham, Alabama.

Arbitration Panel:

Monroe Mitchel, Sole Public Arbitrator

Underlying Case Investments at Issue:

Various Real Estate Investment Trusts ("REITs") including FS Investment Corporation III, American Realty Capital Hospitality Trust, Business Development Corporation of America, FS Energy and Power Fund, and Arc Realty Trust, Inc.

Relief Requested:

(1) Expungement of the Underlying Claims from his CRD records pursuant to FINRA Rule 2080(b)(1)(A), as the claim, allegation, or information is factually impossible or clearly erroneous;

(2) Expungement of the Underlying Claims from his CRD records pursuant to FINRA Rule 2080(b)(1)(C), as the claim, allegation, or information is false;

(3) Damages in the amount of $1.00 from Respondents; and

(4) Any and all other relief that the Arbitrator deems just and equitable.

Settlement Amount: Confidential.
Expungement: Granted
Analysis:

This case involved the Claimant registered representative filing what amounts to a standalone "expungement-only" claim against two broker dealers. Conveniently, neither broker dealer named as a nominal Respondent contested Claimant's request for expungement, rendering the proceeding adversarial in name only. The Claimant also followed an increasingly common strategy of seeking "$1.00" in damages as additional relief in order to take advantage of lower FINRA arbitration fees for smaller claims and obtain appointment of a single arbitrator to hear the case.

As to the expungement of the underlying claims related to investments in REITs for senior citizens, the sole arbitrator concluded that because the retirees in the underlying case were experienced investors and because their son has an MBA and works for a brokerage firm, the investments were suitable. It should be noted that this finding is solely based upon the broker Claimant's testimony: the Arbitrator found that the Customers "had notice of the expungement request and hearing but were either unable to participate or chose not to participate in the expungement hearing." One of the Customers was unavailable in any event as she was deceased.

These standalone "$1.00 damages" arbitration proceedings, filed after the underlying case involving the customer is over and with the employing broker dealer as a nominal respondent, have reportedly proliferated. According to the 2019 PIABA Foundation study, from 2015-2018, the number of cases in which nominal damages were requested in the broker's statement of claim increased from six to 456 cases. In 2018, 84% of all expungement-only cases included a request for nominal damages. In total, brokers requested nominal damages 780 times and 756 (97%) sought the $1.00 expungement arrangement and then withdrew the request at the evidentiary hearing. Further, two law firms reportedly have filed a vast majority of these "expungement-only" cases.

Thomas Wayne Davis, Jr. (Claimant) v. American Independent Securities Group, LLC (Respondent)

Case No. 19-00048

Portland, Oregon

Hearing Dates: Underlying Case Settled in or around January 2019

Expungement Date: September 16, 2019

Counsel:

Counsel for Claimant: Dochtor Kennedy, MBA, J.D. and Erica Harris, Esq., AdvisorLaw, LLC, Westminster, Colorado

Counsel for Respondent: W. Gregory Lockwood, Esq., Gordon & Rees Scully Mansukhani, Portland, Oregon.

Arbitration Panel:

Daniel B. Macleod, Sole Public Arbitrator.

Underlying Case Investments at Issue:

Pacific Indexed Performer LT Indexed Universal Life Policy written by Pacific Life Insurance Company.

Relief Requested:

(1) Expungement of the Underlying Claims from his CRD records pursuant to FINRA Rule 2080(b)(1)(A), as the claim, allegation, or information is factually impossible or clearly erroneous;

(2) Expungement of the Underlying Claims from his CRD records pursuant to FINRA Rule 2080(b)(1)(C), as the claim, allegation, or information is false;

(3) Damages in the amount of $1.00 from Respondents; and

(4) Any and all other relief that the Arbitrator deems just and equitable.

Settlement Amount: $65,000.00.

Expungement: Granted over the Written Objections of the Customer.

Analysis:

In this matter, the sole arbitrator granted expungement over the customer's objection, although the broker Claimant personally paid $45,000 of the $65,000 settlement amount, stating "[t]he arbitrator found that Claimant's contribution was a business decision based on the cost of defense of an arbitration, as further explained in the Award section below."

While this is yet another example of the "$1.00" damages or "expungement only" case in which there is no genuine adversary to the party seeking expungement, what is more inexcusable is the sole arbitrator's character attack on the Customer. In the justification for granting the Claimant's claim that the case was false, the sole arbitrator stated:

> Prior to the hearing, the Customer filed with FINRA a written objection to expungement, which was read and considered. The gist of the Customer's statement was that her underlying complaint was factually accurate; that she never wanted a life insurance policy; and that she objected to expungement.
>
> The Customer did not appear at the hearing, either in person or through her counsel.
>
> ***
>
> The settlement agreement and the CRD entry at issue both state the gross settlement for the release of both parties in the underlying action (Claimant and Respondent herein) was the sum of $65,000, which is the amount claimed by the Customer by way of recession of the insurance policy. This raises a rebuttable presumption that the settlement may reflect actual capability on the part of the settling broker. However, in this case, that presumption does not withstand analysis. .
>
> ***
>
> The insurance carrier opted to settle as a business decision. At the hearing, counsel for Respondent gratuitously and

> unequivocally confirmed the testimony of Claimant that settlement was driven by business considerations.
>
> ***
>
> While any settlement reflects a decision to cut losses and end a dispute, the Arbitrator finds that in this case the settlement was a rational business decision to "buy peace" from a vexatious litigant for less than the anticipated cost of defense; and does not reflect any explicit or tacit recognition or acceptance of culpability.

So, in summary, the sole arbitrator based his conclusion that the customer was a "vexatious litigant" and the settlement was solely based on "business considerations" on the testimony of the broker as well as counsel for the nominal respondent brokerage firm, who "gratuitously and unequivocally confirmed the testimony of Claimant that settlement was driven by business considerations." The sole arbitrator therefore found under Rule 2080 that the customer's claim was "factually impossible and clearly erroneous" and also "false."

Jon Shebel, Susan Shebel, and SEP FBO Jon L. Shebel (Claimants) v. Marshall R. Cassedy, Jr., McNally Financial Services Corporation, David McNally, and Barret Schultz (Respondents)

Case No. 17-03274

Jacksonville, Florida

Hearing Dates: Settled on or about November 9, 2018

Expungement Date: April 3, 2019

Counsel:

Counsel for Claimants: Charles Carlson, Esq., Carlson & Associates, P.A., Miami, Florida.

Counsel for Respondents: Gary S. Kessler, Esq., Kessler & Collins, P.C., Dallas, Texas.

Arbitration Panel

Karl A. Vogeler, III, Public Arbitrator, Presiding Chairperson

Meeta Alberta Bass, Public Arbitrator

David A. Costantino, Non-Public Arbitrator

Investments at Issue:

Various Securities Transactions.

Claimants' Claims:

Causes of Action in Statement of Claim:

(1) Negligence,

(2) Gross negligence,

(3) Breach of contract,
(4) Fraud,
(5) Fraudulent misrepresentation,
(6) Negligent misrepresentation,
(7) Breach of fiduciary duty,
(8) Negligent hiring,
(9) Negligent supervision,
(10) Aiding and abetting fraud,
(11) Aiding and abetting breach of fiduciary duty,
(12) Unsuitability,
(13) Excessive trading,
(14) Churning, and
(15) Violation of FINRA Rules.

Relief Requested:

(1) Compensatory and/or rescissionary damages of all losses in the accounts;
(2) Compensatory and/or rescissionary damages of all commissions;
(3) Well-managed portfolio damages;
(4) Pre-award interest at the lawful rate;
(5) Punitive damages, and
(6) Costs and expenses including expert witness and forum fees.

Settlement Amount: Confidential.

Expungement: Granted over Claimant's Objections during Hearing

Analysis:

The Panel ultimately decided to grant expungements to supervisors of the broker whose conduct was at issue, despite the fact that substantial sums were paid to settle the claims. In finding that the Claimant's claims were "false" over Claimant's opposition, the Panel cited the steps that the supervisors had taken to attempt to supervise the broker.

Among the highlights of the Panel's circular reasoning as to why expungement was granted:

> "Cassedy was granted permission to pursue his profession by both FINRA and the State of Florida. His licensure is indicative that he can do business as a broker, and an employer can rely upon those entities that he is employable as a broker"
>
> "McNally reasonably delegated the supervision of Cassedy to a first officer, and then to Schultz; both officers were qualified to conduct heightened supervision under the plan."
>
> "Schultz took the heightened supervisory plan seriously, assumed responsibility for it and executed it diligently. Schultz spent 2 to 3.5 days each year in Cassedy's office (total of 7 or 8 visits in 50

> months, including the above-mentioned investigations -- significantly more than usual and more than required), inspecting records and e-mails; and doing a "deep dive" into many of his accounts. Schultz ensured Cassedy attended regular compliance meetings. In summary, Cassedy was properly supervised."
>
> "J. Shebel was an experienced investor and senior executive whose net worth appeared to be about $10 million."

In short, the Panel reasoned that because the Claimant was experienced and successful, and the supervisors took some steps to supervise the broker, Claimant's claims were "false" and "clearly erroneous."

Mark Sam Kolta (Claimant) v. National Securities Corporation (Respondent)

Case No. 19-02228

New York, New York

Hearing Dates: Underlying Matters Settled prior to 2020

Expungement Date: March 31, 2020

Counsel:

Counsel for Claimant: Tosh D. Grebenik, JD, FA Expungement, LLC, Denver, Colorado.

Counsel for Respondents: Emily Hayes, Esq., National Securities Corporation, New York, New York.

Arbitration Panel:

Robert E. Anderson, Sole Public Arbitrator

Underlying Matters Investments at Issue:

Purchases in Bank of America, Apple, C-Share bonds, and American Realty Global NYC REIT.

Relief Requested:

(1) Expungement of the Underlying Claims from his CRD records, and

(2) Damages in the amount of $1.00 from Respondents; and

Settlement Amount: Unknown.

Expungement: Granted.

Analysis:

Mark Kolta, despite having eleven events currently listed on his BrokerCheck® Report including multiple customer cases seeking substantial damages that are pending as of this writing, got the benefit of the doubt from this sole arbitrator (appointed due to the $1.00 damages demand), who granted expungement of three separate underlying cases.

In explaining the first case and justifying expungement, the sole arbitrator stated: “The customer purchased two blue chip equities, Bank of America and Apple, after discussing them with Claimant. They subsequently declined in value, and the customer complained to the firm that the purchases had been unauthorized. Respondent investigated the complaint and closed its file having taken no action. The claim was not pursued.”

In explaining the second case and justifying expungement, the Sole Panel Member stated: “The customer was enrolled by Claimant in the firm’s Equity-OTC program in 2016 and invested in the account. After extensive discussions with Claimant, she purchased some C-share bonds. These bonds had no fee if held for one year but cannot be sold within that time frame. The purchase was confirmed by Claimant’s manager. Unfortunately, the customer’s financial situation changed, and she sought to sell the bonds a few months later – a directive which could not be honored. She subsequently complained to Respondent that the purchase was unauthorized. Respondent investigated the complaint and closed its file with no action taken. The customer transferred her account away but took no further action.”

In explaining the third case and justifying expungement, the Sole Panel Member stated: “The customer became Claimant’s client during his previous employment at Chase Investment Services and followed him to National Securities Corporation where she purchased an interest in the American Realty Global NYC Real Estate Investment Trust, or REIT. The purchase entailed acknowledgment of substantial disclosures and documentation and was reviewed for suitability by Claimant’s supervisors. The customer invested in a total of six REITS with Claimant and earned a significant profit over a period of five years. Soon after the American Realty REIT became illiquid in 2016, the customer emailed a complaint to Respondent complaining of lack of suitability. The complaint was investigated by Respondent and was denied as being unfounded. In the interests of preserving the client relationship, the customer’s investment in the above position was refunded by Respondent and the customer remains Claimant’s client.”

In sum, the sole arbitrator reasoned that because the Respondent broker dealer, an adversary of the Claimant broker in name only, investigated the customer complaints against its own employee and found them to be unfounded, expungement was granted. The sole arbitrator also found that all three allegations were “false” based on the nominal Respondent broker dealer’s internal investigations of the claims.

Sandra L. Liebhaber (Claimant) v. Royal Alliance Associates, Inc. (Respondent)
Case No. 13-01522
Los Angeles, California
Hearing Dates: Settled on or about May 14, 2014
Expungement Date: September 10, 2014
Counsel:
Counsel for Claimant: Robert S. Banks, Jr., Esq., Banks Law Office, PC, Portland, Oregon.
Counsel for Respondent: Kasumi L. Takahashi, Esq., Jones, Bell, Abbott, Fleming & Fitzgerald, L.L.P., Los Angeles, California.
Arbitration Panel
Richard J. Stall, Jr., Public Arbitrator, Presiding Chairperson
June McLaughlin, Public Arbitrator
Carole Helfert Aragon, Public Arbitrator
Investments at Issue:
Claimant's investments in Ohio National Life Insurance Variable Annuity, Hartford Director M Outlook Variable Annuity, Hartford Leaders Outlook Variable Annuity, SunAmerica Annuity and Life Assurance Variable Annuity and Inland American Real Estate Trust, Inc.
Claimants' Claims:
Causes of Action in Statement of Claim:
(1) Negligence;
(2) Breach of fiduciary duty; and
(3) California securities law violations.
Relief Requested:
(1) Recovery of the amounts Claimant paid for her investments, less any distributions she may have received up to the time of the award, plus statutory and prejudgment interest, and for investments no longer held by Claimant, recovery of damages plus interest, all in an amount to be proved at the hearing but not less than $325,000.00;
(2) Claimant's costs in bringing this case, including filing fees, expert witness fees, and hearing fees; and
(3) Such other relief as the Panel may deem appropriate at the conclusion of the hearing.
Settlement Amount: $30,000.00 (100% of net out-of-pocket losses, according to Claimant's counsel)
Expungement: Granted over Claimant's Attorney's Objections during Hearing
Post Expungement: Petition to Confirm Denied and upheld by the Court of Appeal of the State of California

Analysis:

Nonparty broker Kathleen Tarr, who reportedly accumulated 42 customer complaint during a twelve-year period, sought post-settlement expungement. At the expungement hearing, on behalf of Tarr, counsel for Royal Alliance presented her argument and then requested an opportunity for Ms. Tarr to make a statement in support of her expungement application. Ms. Tarr spoke about how she was "the daughter and granddaughter of ministers" and vigorously denied the claims. The Panel allowed Ms. Tarr to speak uninterrupted.

When Claimant's Counsel requested to ask some questions of Ms. Tarr, counsel for Royal Alliance's objected and the Panel sustained the objection, with the Chair stating "I'm comfortable with us asking Ms. Tarr questions, but I am uncomfortable with claimant's counsel cross-examining her in any way." Further, Claimant was denied her right to present evidence, despite being available to testify.

Ultimately, the Panel granted the expungement and Royal Alliance petitioned the trial court to confirm the expungement award. The Claimant and FINRA opposed, on the basis that the Panel's refusal to hear the Claimant's evidence and cross-examine Ms. Tarr was a deprivation of a fair hearing that substantially prejudiced her rights. The trial court agreed and the court of appeals affirmed, stating in relevant part as follows: "Simply put, the hearing was not fair. The arbitrators gave Royal Alliance an unfettered opportunity to bolster the written record but denied Liebhaber even a limited chance to do the same." *See Royal Alliance Assocs., Inc. v. Liebhaber,* 2 Cal. App. 5th 1092, 1111, 206 Cal. Rpr. 3d 805 (2016).

CASES & MATERIALS

Philip Vujianov

The Tenth Circuit finds that a court lacks authority under the FAA to modify an arbitration award resulting in "double recovery" unless there is an evident material miscalculation on the face of the award.

Mid Atl. Capital Corp. v. Bien, 956 F.3d 1182 (10th Cir. 2020):

Accountholders of Mid Atlantic Capital Corp. ("Mid Atlantic") initiated a FINRA arbitration claim against Mid Atlantic following recommendations to purchase REIT investments, resulting in losses. *Mid Atl. Capital Corp. v. Bien*, 956 F.3d 1182, 1187 (10th Cir. 2020). During the arbitration hearing, the investors' expert witness offered two methods of calculating losses: (1) "net out-of-pocket" losses, or (2) "market adjusted losses." *i.e.*, "the difference between what [investors] would have received if they had been invested in a diversified portfolio and what they actually received by investing in the riskier investments at issue." *Id*. During closing arguments, investors requested only market-adjusted losses. *Id*. The arbitration panel ruled in favor of the investors, awarding "two forms of damages: (1) initial-investment loss damages and (2) compensatory damages," as well as interest, attorneys fees and costs. *Id*. at 1188.

Mid Atlantic moved the district court to modify the arbitration award, arguing that it contained "an evident material miscalculation of figures." *Id*. Specifically, Mid Atlantic argued that when the panel awarded investors *both* forms of damages requested – net out-of-pocket losses and market-adjusted losses - it resulted in a "double recovery." *Id*. Although the district court found that investors effectively received a double recovery and found the award "disturbing," it sided with the investors. *Id.* at 1189. The court reasoned that the Federal Arbitration Act ("FAA") 9 U.S.C. § 11(a) authorized it to correct "an evident material miscalculation of figures only if the miscalculation appeared on the face of the award." *Id*. Since the award contained no analysis of how the award was calculated and the alleged double recovery appeared "only upon looking to the arbitration record," the court concluded that it lacked authority under the FAA to modify the award. Mid Atlantic appealed the district court's decision.

The Tenth Circuit began its analysis by noting that courts must give "extreme deference" to an arbitration panel's conclusions because "review of arbitral awards is among the narrowest known to law." *Id*. at 1189, citing *THI of N.M at Vida Encantada, LLC v. Lovato*, 864 F.3d 1080, 1083 (10th Cir.

2017). The Court further noted that the "principal purpose [of the FAA] … is to ensure that private arbitration agreements are enforced according to their terms." *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 344 (2011). In agreeing to arbitration in which an arbitration panel decides the outcome, the parties "trade the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985). "This bargain essentially negates the risk that a court may substitute its judgement (inadvertently or otherwise) for that of the arbitrator when it goes beyond the award's face in search of obvious, material mathematical errors." *Mid Atl. Capital Corp.,* 956 F.3d at 1193. If § 11(a) were read to allow courts to "hunt through the arbitration record for evident miscalculations," it would open the door to "the full-bore legal and evidentiary appeals that the parties would have contracted to avoid." *Id.*

The Court concluded its analysis by observing that Mid Atlantic had the opportunity to request a reasoned opinion from the Panel but declined to do so and "if Mid Atlantic wished to avoid the supposedly random chance that the arbitration panel would not show its work, it could have contracted for a fully explained award." *Id.* at 1196. As such, the Court confirmed the lower court's determination that it lacked authority under the FAA to modify the award.

FINRA members agree to FINRA rules regarding service of claims and must take appropriate steps to ensure that such notices are received.

Matter of New Brunswick Theological Seminary v. Van Dyke, 184 A.D.3d 176, 125 N.Y.S.3d 153 (App. Div.):

Appellant Victoria Anne Van Dyke was a former FINRA-registered broker. *Matter of New Brunswick Theological Seminary v. Van Dyke*, 184 A.D.3d 176, 177, 125 N.Y.S.3d 153, 156 (App. Div.) Van Dyke registered a New York residential address with FINRA, however she spent long periods of time away from her New York residence during the year. *Id*. New Brunswick Theological Seminary, a former client of Van Dyke's, initiated a FINRA arbitration action against Van Dyke. All documents regarding the arbitration were sent via certified mail to Van Dyke's New York address on file with FINRA. Van Dyke, who was not at the New York address for a length of time, did not receive any of the documents and, as such, did not know of the pending arbitration action against her and did not make an appearance. *Id*. New Brunswick Theological Seminary commenced a proceeding to confirm an arbitration award against Van Dyke, totaling over $3 million. *Id*. Van Dyke cross-moved for to vacate the arbitration award, arguing that "certified mail was not reasonably calculated to place her on notice of the arbitration because the petitioner knew that she could be contacted by email and knew she spent long periods of time away from her New York residence" and that "the contractual method used to provide notice of the arbitration … worked to deprive her of her constitutional right to procedural due process. *Id*.

The court began its analysis by noting that "ordinarily, a court can acquire jurisdiction of a person of a defendant only by service of process within the jurisdiction of the court; but that rule does not apply where the defendant has agreed to accept, or does in fact accept, some other form of service as sufficient." *Id*., citing *Pohlers v. Exeter Mfg. Co*., 293 N.Y. 274, 279 (1944). Where parties to an arbitration agreement consent to an alternative method of service, "the method of service by which the parties have agreed to be bound must be complied with according to the exact terms thereof in order that the requirements of due process be satisfied." *Id*. Questions of compliance with such procedures are for resolution by the arbitrators and the court's review of an arbitrator's determination is limited. *Id*.

The court found that the arbitrator in the case determined that Van Dyke was properly served in accordance with FINRA's rules and that Van Dyke agreed to arbitrate the dispute pursuant to FINRA rules, which set forth mailing procedures by which service must be effected:

> In this case, we have little difficulty in concluding that the appellant is bound by the procedure to which she consented. The appellant agreed to receive notice of any dispute requiring arbitration by certified mail sent to an address she provided to FINRA … The appellant was on notice of the method by which she would receive notifications and, by agreeing to that method, she was bound to take steps to ensure that such notice would be received.

Id. at 160. Further, the court rejected Van Dyke's argument that the contractual notice provision should be invalidated on public policy grounds: "The fact that with the benefit of hindsight, a party believes that it had agreed to an unfavorable contractual term, does not provide courts with authority to rewrite the terms of a contract or to extricate parties from poor bargains." *Id*., citing *159 MP Corp. v. Redbridge Bedford, LLC*, 71 N.Y.S.3d 87, 98 (App. Div. 2018).

Southern District of New York finds that a forum-selection clause found in a contract displaces the agreement to arbitrate claims in FINRA under Rule 12200.

N.Y. Bay Capital, LLC v. Cobalt Holdings, Inc., No. 1:19-cv-3618-GHW, 2020 U.S. Dist. LEXIS 74583 (S.D.N.Y. Apr. 27, 2020):

Cobalt Holdings, LLC ("Cobalt") hoped to raise funds to finance a telecommunications project. *N.Y. Bay Capital, LLC v. Cobalt Holdings, Inc.*, No. 1:19-cv-3618-GHW, 2020 U.S. Dist. LEXIS 74583, at *1 (S.D.N.Y. Apr. 27, 2020). Cobalt contracted with N.Y. Bay Capital, LLC ("NYBAY") for investment banking services. Id. at *1-3. The contract between the parties contained a forum-selection clause to "irrevocably submit to the exclusive jurisdiction of the United States District Court for the Southern District of New York any action, suit or proceeding arising out of or relating to this Engagement or any of the transactions contemplated hereby, and agrees that any such action, suit or proceeding shall be brought only in such court." Id. at *2-3. The contract also contained a merger clause: "This Engagement sets forth the entire understanding of the parties relating to the subject matter hereof and supersedes and cancels any prior communications, understandings and Engagements between the parties with respect to the subject matter hereof." *Id.* at *7.

Cobalt eventually secured financing through a different investment bank and NYBAY brought a breach of contract action against Cobalt in the Southern District of New York. Nine months later, Cobalt initiated a separate FINRA arbitration claim against Julio Marquez, a FINRA member and the managing partner who signed the contract on behalf of NYBAY. *Id.* at *4. Another FINRA member, Young America Capital LLC ("YAC") was also named as a respondent in the action. The arbitration claim alleged that "Marquez violated United States federal securities laws and FINRA rules because NYBAY acted as an investment bank to Cobalt, even though it is not registered as a broker dealer." *Id*. at *10. NYBAY moved the court to enjoin the FINRA arbitration based on the forum-selection clause in the contract it signed with Cobalt. *Id*.

Cobalt argued that if the Court precluded it from arbitrating before FINRA, it would have "no forum" in which to bring its third-party claims against Marquez and YAC, since neither was a signatory to the contract. *Id*. *7. Although parties who are not signatories to a contract cannot be bound to the terms of the contract, the court found that "Cobalt is a signatory to the Contract, so this rule does not preclude the NYBAY from demonstrating that is likely to succeed on the merits of its argument that the forum-selection clause in the Contract applies to the FINRA Arbitration." *Id*. at *15. Moreover, the court determined that the FINRA arbitration action was "inextricably linked to claims covered by a forum-selection clause" and, thus, "the FINRA Arbitration falls within the Contract's forum-selection clause." *Id*. at * 14-16. As such, the Court rejected Cobalt's argument: "Cobalt has a forum in which to bring its claims against Marquez and YAC because, pursuant to the forum-selection clause in the Contract, it can bring them in this Court." *Id.*

The court found that the forum selection clause in the contract was unambiguous and displaced the agreement to arbitrate in FINRA under FINRA Rule 12200: "the forum-selection clause displaces the agreement to arbitrate in FINRA Rule 12200." The court stated that its conclusion was compelled by the Second Circuit's decision in Goldman, Sachs & Co. v. Golden Empire Sch. Fin. Auth., 764 F.3d 210, 216 (2d Cir. 2014). *Id*. at *12-13. Although Cobalt offered FINRA Regulatory Notice 16-25 to support its argument that "FINRA Rules are not mere contracts" but "have the force of federal law," the court determined that it "must follow binding precedent, even if it conflicts with FINRA guidance on the issue." *Id*. at *17. As such, the court granted NYBAY's motion to enjoin the FINRA arbitration proceeding. *Id*. at *20.

FINRA arbitration panel dismisses a party's claim, with prejudice, for failure to comply with a discovery order.

Piston v. Transamerica Capital, Inc., No. 19-1123, 2020 U.S. App. LEXIS 22659 (10th Cir. July 21, 2020):

Zane Piston was a registered representative of Transamerica Capital, Inc. ("Transamerica"). *Piston v. Transamerica Capital, Inc.*, No. 19-1123, 2020 U.S. App. LEXIS 22659, at *1 (10th Cir. July 21, 2020). Following his termination, Mr. Piston initiated a FINRA arbitration against Transamerica, arguing it incorrectly described the reason for his termination which harmed his ability to secure employment elsewhere. *Id*.

During the arbitration proceeding, the arbitration panel granted Transamerica's motion to compel and ordered Mr. Piston to produce various documents. *Id*. at *2. Transamerica filed a motion for sanctions after Mr. Piston failed to comply with the panel's order. While the sanctions motion was pending, Mr. Piston likewise failed to comply with the scheduling order in serving his witness list, arbitration brief, and supplemental documents. *Id*. Transamerica filed another motion for sanctions and requested the panel to dismiss Mr. Piston's claims. *Id*. at *3. The panel ultimately postponed the evidentiary hearing and scheduled a telephonic hearing with the parties "to show good cause why Transamerica's sanction of dismissal should not be granted." *Id*. In a statement of good cause submitted to the panel, Mr. Piston's counsel explained that he underwent dental surgery, travelled to Europe to visit his son who was studying abroad, and then remained at the hospital for several days, where his wife was hospitalized after experiencing a serious medical incident. *Id.* at *3-4. The panel found no good cause existed and dismissed Mr. Piston's claims "with prejudice as a sanction due to the material and intentional failure to comply with prior orders of the Panel despite its efforts to advise [Mr. Piston's] counsel of the need to comply with FINRA rules and deadlines." *Id*. at *4. The district court denied Mr. Piston's motion to vacate the panel's award, and Mr. Piston appealed. *Id*.

Mr. Piston argued that the arbitration panel exceeded its powers, manifestly disregarded the law and denied him a fundamentally fair hearing. Specifically, Mr. Piston's argument was based on FINRA Rule 13212(c), allowing a panel to dismiss a claim "with prejudice as a sanction for material and intentional failure to comply with an order of the panel if prior warnings or sanctions have proven ineffective." *Id*. at *6. Mr. Piston argued that for the rule to apply, a warning or sanction had to already have been issued and no such warnings or sanctions had been issued in his case at the time of dismissal. *Id*. In rejecting this argument, the Tenth Circuit found that the panel's findings that Mr. Piston's intentional and material failure to comply with the panel's order, aligned with Rule 13212. Further:

> At its core, Mr. Piston's argument alleges that the panel erroneously applied Rule 13212(c) by dismissing his claims without prior warning or sanction. Perhaps reasonable people could disagree about whether sufficient warning occurred under Rule 13212(c) through the panel's scheduling order, the panel's order compelling discovery, TCI's sanctions motions, the panel's order requiring Mr. Piston to show good cause to avoid dismissal, or some combination of those things. But whether the panel correctly interpreted Rule 13212(c) is beyond the scope of our review. So long as the panel arguably applied the Rule—and it did—we may not disturb its award.

Id. at *7-8. As such, the Court found that, "applying the narrow standard of review that governs our review of arbitration awards," there was no basis for reversal of the district court's decision. *Id*. at *5.

California court holds that there is no right to pre-hearing discovery under the Federal Arbitration Act.

Aixtron, Inc. v. Veeco Instruments Inc., Nos. H045126, H045464, 2020 Cal. App. LEXIS 667 (Ct. App. July 16, 2020):

Veeco Instruments, Inc. ("Veeco") initiated an arbitration action under the JAMS Employment Arbitration Rules and Procedures against a former employee, after he left his position at Veeco to join a competitor, Aixtron, Inc. ("Aixtron"). *Aixtron, Inc. v. Veeco Instruments Inc.*, Nos. H045126, H045464, 2020 Cal. App. LEXIS 667 (Ct. App. July 16, 2020). Veeco requested a pre-hearing discovery subpoena directed to Aixtron for the production of "any computers that Saldana had used for forensic examination." *Id*. at *2. Over Aixtron's objection, the arbitrator granted Veeco's motion and compelled Aixtron to comply with the subpoena. *Id*. Aixtron initiated a special proceeding in superior court seeking judicial review of the subpoena and Veeco filed a separate petition to enforce the subpoena. *Id*. The court granted Veeco's petition and Aixtron appealed. *Id*.

According to Aixtron, "the central issue before this Court is whether the arbitrator is authorized by federal [Federal Arbitration Act] or state [California Arbitration Act] statute to issue a deposition subpoena for the production of business records to a [nonparty] outside of the context of the arbitration hearing." *Id*. at *27. Thus, the court reviewed the language of the Federal Arbitration Act and California Arbitration Act to determine whether an arbitrator has authority to compel a nonparty to the arbitration to produce documents in response to a discovery subpoena for business records, issued by an arbitrator.

The court began its analysis by examining the right to discovery under the FAA: "The right to discovery under the FAA is limited. Under section 7 of the FAA (9 U.S.C. § 7), arbitrators are authorized to subpoena nonparties to appear before them and to produce documents or other evidence, and the arbitrator's subpoena is enforceable by the district court."

The court then turned to a review of *CVS Health Corp. v. Vividus*, LLC, 878 F.3d 703 (9th Cir. 2017):

> After reviewing section 7 of the FAA and opinions from other federal appellate courts, the Ninth Circuit [in *CVS Health Corp. v. Vividus*, LLC, 878 F.3d 703 (9th Cir. 2017)] concluded that the FAA does not grant arbitrators that power and affirmed the district court. The court held that section 7 of the FAA gives arbitrators two powers: (1) to compel the attendance of persons to appear as witnesses at the hearing and (2) to compel such persons to bring relevant documents

> to the hearing. The court held that a "plain reading of the text of section 7 reveals that an arbitrator's power to compel the production of documents is limited to production at an arbitration hearing," and that "section 7 grants an arbitrator no freestanding power to order third parties to produce documents other than in the context of a hearing."

Id. at 55-56. The *CVS Health* is in contrast to the Eight Circuit's decision in *Sec. Life Ins. Co. of Am. v. Duncanson & Holt (in Re Sec. Life Ins. Co. of Am.)*, 228 F.3d 865 (8th Cir. 2000), that "implicit in an arbitration panel's power to subpoena relevant documents for production at a hearing is the power to order the production of relevant documents for review by a party prior to the hearing,'" which furthered "efficient resolution of disputes by allowing parties to 'review and digest' documents before hearings." The *CVS Health* court rejected this rationale:

> it is not absurd to restrict third-party discovery to the disclosures that can be made at a hearing; third parties 'did not agree to [the arbitrator's] jurisdiction' and this limit on document discovery tends to greatly lessen the production burden upon non-parties … Under a system of pre-hearing document production, by contrast, there is less incentive to limit the scope of discovery and more incentive to engage in fishing expeditions that undermine some of the advantages of the supposedly shorter and cheaper system of arbitration.'[] … Practical constraints on document production during an arbitration hearing may often result in lower production demands upon third parties. Moreover, an arbitrator's power under section 7 extends only to documentary evidence 'which may be deemed material … ,' further demonstrating that under the FAA an arbitrator is not necessarily vested with the full range of discovery powers that courts possess."

CVS Health Corp. 878 F.3d at 708.

The court found *CVS Health's* reasoning persuasive and adopted its holding. *Aixtron, Inc.*, 2020 Cal. App. LEXIS 667 at *57. Specifically, it determined that there is no right to pre-hearing discovery under the Federal Arbitration Act or the California Arbitration Act and since the arbitrator did not have authority to issue the discovery subpoena, reversed the lower court's ruling. *Id*. at *3.

The Dodd-Frank Act authorizes the SEC to promulgate Regulation Best Interest, which "prioritize[s] consumer choice and affordability over the possibility of reducing consumer confusion."

XY Planning Network, LLC v. United States SEC, 963 F.3d 244 (2d Cir. 2020):

In 2019, the Securities and Exchange Commission adopted Regulation Best Interest, which established a new standard of care for broker-dealers serving retail customers. *XY Planning Network, LLC v. United States SEC,* 963 F.3d 244 (2d Cir. 2020). Specifically, Regulation Best Interest purports to impose a "best interest obligation" on broker-dealers to "act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the [broker-dealer] … ahead of the interest of the retail customer."

> The best-interest obligation has four components: (1) a "disclosure obligation," requiring broker-dealers to disclose any material facts relating to the scope and terms of the relationship with the customer, as well as all material conflicts of interest related to their investment recommendations; (2) a "care obligation," requiring broker-dealers to "[h]ave a reasonable basis to believe that the recommendation is in the best interest of" the customer; (3) a "conflict of interest obligation," requiring broker-dealers to identify, mitigate, and disclose conflicts of interest and to "[p]revent" conflicts that would cause them to "make recommendation[s] that place [their own] interest ahead of the" customers'; and (4) a "compliance obligation" requiring broker-dealers to adopt policies and practices "reasonably designed to achieve compliance with Regulation Best Interest.

A lawsuit was brought by an adviser interest group ("XYPN") and a group of states ("state petitioners"), claiming Regulation Best Interest is unlawful:

> XYPN contends that Regulation Best Interest will injure investment advisers by making it more difficult for them to differentiate their standard of care from that of broker-dealers in advertising to attract customers. Julie Ford, owner of Ford Financial Solutions, LLC (together, "Ford"), attests that Ford "currently attract[s] and retain[s] clients by, in part, highlighting [the] firm's fiduciary duty to clients," in contrast to the less stringent suitability standard governing broker-dealers. XYPN Ford claims that under Regulation Best Interest, broker-dealers will be able to advertise that they must act in their clients' "best interests" just as Ford does, even

> though they will face "comparatively fewer regulatory obligations, lower compliance costs, and less legal exposure." The State Petitioners claim that Regulation Best Interest will diminish their tax revenues from investment income by allowing broker-dealers to provide conflicted investment advice to customers, which would be prohibited under a uniform fiduciary standard. The State Petitioners cite expert evidence claiming that "[t]he loss of retail investment returns due to conflicted financial advice causes harm to states by lowering their tax revenues."

The Second Circuit first found that XYPN had Article III standing - requiring a showing of suffered injury in fact that is fairly traceable to the challenged conduct of defendant – as it made a concrete showing that Regulation Best Interest would result in impairment to specific business practices. In contrast, state petitioners did not have Article III standing because "they failed to establish a direct link between Regulation Best Interest and their tax revenues."

Next, the court addressed the legality of Regulation Best Interest under the Dodd-Frank Act:

> Congress stated that the SEC "may commence a rulemaking, as necessary or appropriate in the public interest and for the protection of retail customers . . . to address the legal or regulatory standards of care for" broker-dealers. Dodd-Frank Act § 913(f) This broad grant of permissive rulemaking authority encompasses the best-interest rule adopted by the SEC. Contrary to Petitioners' argument, Section 913(g) does not narrow the scope of Section 913(f) but rather provides a separate grant of rulemaking authority.
>
> The key language in each of the provisions at issue is "may," which is permissive and reflects Congress's grant of discretionary rulemaking authority to the SEC. See id. § 913(f) ("The Commission may commence a rulemaking . . .") … Congress gave the SEC the authority to promulgate rules under any of these sections—or to make no rule at all. With Regulation Best Interest, the SEC chose to proceed under Section 913(f), not Sections 913(g)(1) or (g)(2).

As such, the court determined that the Dodd Frank Act authorized the SEC to promulgate Regulation Best Interest. Finally, the court concluded that Regulation Best Interest is not arbitrary or capricious:

> The SEC explicitly recognized that a uniform standard of care may "reduce retail investor confusion as it would ensure that investors are provided the same standard of care and loyalty regardless of what type of financial professional they engage." But the SEC weighed these benefits against the "significant compliance costs" for broker dealers that could cause "retail customers [to] experience an increase in the cost of obtaining investment advice" and lead to "the potential exit of broker-dealers from the market."

Thus, the court found that Regulation Best Interest was not arbitrary or capricious because the SEC gave "adequate reasons for its decision to prioritize consumer choice and affordability over the possibility of reducing consumer confusion, and it supported its findings with substantial evidence."

Notes & Observations

WHERE WE STAND

Historically, PIABA has commented on a number of issues,[1] on both a formal and an informal basis, which are directly applicable to our promotion of the interests of public investors in securities arbitration proceedings that are conducted before the Financial Industry Regulatory Authority ("FINRA").

For example, among the issues that generated the most interest, from and/or on behalf of the members of our association, were proposed amendments to the rules concerning:

- Abusive pre-hearing dispositive motion practices; and
- The adoption of specific procedures that arbitrators will be required to follow before granting the extraordinary remedy of the expungement of prior customer complaints from the registration records of registered representatives.

In this section of the *PIABA Bar Journal*, we will share with our readers the comment letters and formal positions that have been submitted on behalf of our association, during the quarter, to the various regulatory authorities so that all of our constituents will know exactly where we stand.

1. To review all PIABA Comment letters, visit www.PIABA.org. For more information, contact Samuel Edwards at sedwards@sseklaw.com, or David Meyer at dmeyer@meyerwilson.com or Robin S. Ringo at rsringo@piaba.org for assistance.

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The following Comment Letter regarding *Application No. D-12011, Docket ID No. EBSA-2020-0003: Improving Investment Advice for Workers & Retirees* was submitted to the U.S. Department of Labor by Samuel Edwards on August 6, 2020. (prepared with the assistance of Christine Lazaro, Teresa Verges, Matthew Thibaut, David Meyer and Michael Edmiston).

Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Re: Application No. D-12011, Docket ID No. EBSA-2020-0003
Improving Investment Advice for Workers and Retirees

To Whom It May Concern:

I write on behalf of the Public Investors Advocate Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors in disputes with the securities industry and financial advisors. Since its formation in 1990, PIABA has promoted the interests of the public investor in all dispute resolution forums, worked with legislators and regulators to craft the best laws and rules to protect investors, while also advocating for public education regarding investment fraud and industry misconduct.

In 2016, the Department of Labor (the "Department") adopted a final regulation titled "Conflict of Interest Rule—Retirement Investment Advice" (the "Fiduciary Rule"), as well as two new administrative class exemptions from the prohibited transaction provisions of ERISA and the Internal Revenue Code (the "IRC").[1] In 2018, the United States Court of Appeals for the Fifth Circuit vacated the Department's Fiduciary Rule and accompanying class

1. Dep't of Labor, Definition of the Term ''Fiduciary''; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,945 (Apr. 8, 2016) ("Fiduciary Rulemaking"); Dep't of Labor, Best Interest Contract Exemption; Correction, 81 Fed. Reg. 44,773 (July 11, 2016); Dep't of Labor, Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs; Correction, 81 Fed. Reg. 44,784 (July 11, 2016).

exemptions.[2] In 2019, the Securities & Exchange Commission (the "Commission") adopted two regulations governing investment advice titled, "Regulation Best Interest: The Broker-Dealer Standard of Conduct" (commonly referenced as "Reg. BI"),[3] and "Form CRS Relationship Summary and Amendments to Form ADV."[4] Most recently, on July 7, 2020, the Department adopted a final rule, which reinstated the regulation in effect prior to the Fiduciary Rule (the "1975 Regulation").[5] On the same day, the Department proposed a new class exemption (the "2020 Proposal").[6]

PIABA offers this comment, both in response to the Department's reinstatement of the 1975 Regulation and the 2020 Proposal. The Department has only provided thirty days for comment on the 2020 Proposal. On July 8, 2020, PIABA joined with twenty other groups to seek an extension of the comment period.[7] Had additional time been provided, PIABA may have been able to provide a more extensive comment, however, this proposal is significantly important, and hence PIABA has endeavored to submit a meaningful comment within the time period set by the Department.

PIABA is troubled by the lack of protection that will be afforded to workers and retirees by the Department's reinstatement of the 1975 Regulation and by its 2020 Proposal. As has been amply demonstrated by the prior rulemaking referenced above, and in PIABA's prior comments to the past rulemaking, investors rely on those providing investment advice, and expect that those providing advice will be acting in the investors' best interests.

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2. *Chamber of Commerce of United States of Am. v. United States Dep't of Labor*, 885 F.3d 360, 388 (5th Cir. 2018), judgment entered sub nom. *Chamber of Commerce of Am. v. United States Dep't of Labor*, No. 17-10238, 2018 WL 3301737 (5th Cir. June 21, 2018).

3. Securities & Exchange Comm., Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318 (July 12, 2019) (to be codified at 17 C.F.R. pt. 240) ("Reg. BI").

4. Securities & Exchange Comm., Form CRS Relationship Summary; Amendments to Form ADV, 84 Fed. Reg. 33,492 (July 12, 2019) (to be codified at 17 C.F.R. pts. 200, 240, 249, 275, and 279) ("Form CRS").

5. Dep't of Labor, Conflict of Interest Rule-Retirement Investment Advice: Notice of Court Vacatur, 85 Fed. Reg. 40,589 (July 7, 2020).

6. Dep't of Labor, Improving Investment Advice for Workers & Retirees, 85 Fed. Reg. 40,834 (July 7, 2020) ("2020 Proposal").

7. PIABA, *et al.*, Letter to Dep't of Labor (July 8, 2020), available at https:// consumerfed.org/wp-content/uploads/2020/07/DOL-Advice-Rule-Extension-Request.pdf.

Neither the 1975 Regulation, nor the 2020 Proposal meet investors' expectations, which will leave investors vulnerable to the harm that results from improper and conflicted advice.

I. The 1975 Regulation's "Five-Part Test" Should Be Replaced

As mentioned above, the Department recently reinstated the 1975 Regulation. The 1975 Regulation contains a five-part test that must be satisfied before someone will be deemed to be giving investment advice under ERISA and the IRC. If the investment advice is provided for a fee, the person is an Investment Advice Fiduciary. The regulation remained unchanged for 40 years, although the investment advice industry changed drastically. In 2016, when it adopted its Fiduciary Rule, the Department acknowledged that the five-part test had "significantly narrowed the breadth of the statutory definition of fiduciary investment advice."[8] The Department recognized that many who provide investment advice did not meet the five-part test, and as a result, were not investment advice fiduciaries, despite the "critical role they play in guiding plan and IRA investments."[9] As a result, the 1975 Regulation has allowed many advisers to operate with conflicts of interest, conflicts that would be prohibited if they were Investment Advice Fiduciaries.[10]

Now, the Department has reinstated the five-part test where a person shall be deemed to be rendering investment advice under ERISA and the IRC, if the person:

(1) renders advice with respect to the plan or IRA as to the value of securities or other property, or makes recommendations as to the advisability of investing in, purchasing, or selling securities or other property;
(2) on a regular basis;
(3) pursuant to a mutual agreement, arrangement, or understanding with the plan, plan fiduciary or IRA owner, that,
(4) the advice will serve as a primary basis for investment decisions with respect to plan or IRA assets; and that
(5) the advice will be individualized based on the particular needs of the plan or IRA.[11]

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8. Fiduciary Rulemaking, *supra* n. 1, 81 Fed. Reg. at 20,946.

9. *Id.*

10. *Id.*

11. *See* 29 C.F.R. § 2510.3-21(c); 26 C.F.R. § 54.4975-9(c).

The same conflict issues the Department identified when it first replaced the five-part test in 2016 continue to exist today. Under the 1975 Regulation, many who provide investment advice will not meet all five parts of the test, thereby never being deemed Investment Advice Fiduciaries. Those advisers will continue to be allowed to be influenced by conflicts of interest and engage in transactions that would be prohibited if those same advisers were fiduciaries.

Firms have begun to reintroduce conflicts of interest that were disappearing in the wake of the adoption of the Fiduciary Rule. For example, in 2018, Merrill Lynch launched a program whereby early career advisors would be paid a guaranteed salary, so long as they met certain targets for bringing in new assets.[12] This type of compensation arrangement would not have been permitted under the Fiduciary Rule as it creates an improper incentive for Investment Advice Fiduciaries to place their own interests ahead of investors' interests. This is true because, under this Merrill Lynch program, advisors must acquire new assets if advisors are to continue to receive a salary. The advisors are incentivized to provide advice to rollover assets from a 401(k) or other retirement plan to an IRA to meet those targets.

These conflicts will become more widespread, as firms once again have certainty they will not be deemed to be Investment Advice Fiduciaries. Firms had been able to escape coverage under the 1975 Regulation by ensuring they simply did not meet the five-part test, generally by utilizing account agreements that specifically disclaimed one or more elements of the five-part test. For example, firms would state they were not providing advice on a regular basis, or that there was no agreement that any recommendation made was the primary basis for any investment decision in the account. Now that the 1975 Regulation is reinstated, firms will likely again utilize agreements with investors which set forth their purported understanding that any advice the firm provides is not on a regular basis and is pursuant to a supposed mutual agreement that it is not a primary basis for the investment decision. Accordingly, firms will continue to operate pursuant to conflicts of interest, harming investors and depleting their retirement savings.

CONFLICTED ADVICE HARMS RETIREES

Grant, 81, and Dorothy, 77, were retirees who turned over their hard-earned retirement funds which they spent a lifetime saving to a broker, Jarrod. They invested $150,000 with Jarrod, who told them he was going to employ the

12. Stephanie Forshee, "Merrill Sweetens Pay Plan for Upstart FAs," Financial Advisor IQ (July 29, 2020), available at https://financialadvisoriq.com/c/2828893/344913/merrill_sweetens_plan_upstar.

"Bull-Bear Strategy." This strategy involved active trading of an investor's portfolio using primarily individual stocks and exotic Exchange Traded Funds to follow market trends. In the seven months that Jarrod employed this risky strategy, he earned for himself almost $15,000 in commissions, while Grant and Dorothy lost over $25,000 – a sixth of their portfolio.

The Department should adopt a definition of investment advice that conforms with the current economic environment. For example, when the Department first promulgated the five-part test in 1975, Congress had not yet modified the tax code to allow for employees to contribute a portion of their salary to 401(k) plans and most retirement assets were in defined-benefit pension plans. That change came in 1978 and eventually ushered in the current defined-contribution era.[13] The Department should replace the five-part test and remove the inappropriate restrictions it placed on the statutory definition of fiduciary investment advice in 1975. In its place, the Department should promulgate a regulation that will establish that all individuals providing investment advice to plans and IRAs are fiduciaries, regardless of whether that advice is given on a regular basis, and regardless of whether there has been a mutual agreement that the advice will serve as the primary basis for the investment decision. This would be consistent with the statute, and with Congress's intent when it adopted ERISA.

A. Remove the Regular Basis Requirement

The Department could do substantial good by removing the second prong of the five-part test, the requirement that advice must be given "on a regular basis." Single-shot events, like the sale of illiquid securities such as REITs, TICs and private placements; annuities, or other insurance products; or a decision about whether to "rollover" assets from one account type to another have substantial impacts on a person's retirement. When it adopted its Fiduciary Rule in 2016, the Department recognized this issue and found that *trillions* of dollars shifted each year with rollover transactions.[14] The "regular basis" requirement now excludes these transactions from ERISA's scope and

13. Revenue Act of 1978, Pub. L. No. 95-600, § 135, 1978 U.S.C.C.A.N. (92 Stat.) 2763, 2785-87 (codified at IRC § 401(k) (2000)).

14. *See* Fiduciary Rulemaking, *supra* n. 1, 81 Fed. Reg. at 20,949 ("these rollovers are expected to approach $2.4 trillion cumulatively from 2016 through 2020.").

allows assets accumulated under ERISA's protection to be dissipated without protection.

The "regular basis" requirement results in applying different standards to identical activities with identical effects. A consultant who regularly provides advice with respect to a series of transactions would be a fiduciary when giving advice about the investment of an entire pool of assets. Yet, if a different consultant were hired to invest an entire pool of assets in a single transaction, the second consultant would not be bound by fiduciary obligations even though they would do the exact same thing with the same effects. Maintaining the "regular basis" requirement effectively allows single-shot transactions to misallocate ERISA-protected assets with impunity.

B. Remove Requirements That an Investor and Advisor Mutually Agree That Advice Will Serve as the Primary Basis for an Investment

The Department should also reaffirm its prior conclusion the "mutual agreement" and "primary basis" requirements should be modified because it does not conform to the current defined-contribution plan environment.[15] Under the five-part test, a person may escape fiduciary status by arguing that there was no "mutual agreement" that their advice would be a "primary basis" for an investment decision. Fine print in sales contracts disclaiming any mutual agreement and claiming that the purchaser warrants that they have made their own decision by signing the agreement are now proffered to rebut the existence of any mutual agreement.

This loophole allows salespeople to exploit the wide financial sophistication gap between Americans and the financial services industry. Americans often struggle to understand even rudimentary financial concepts.[16] The Department should not abdicate its responsibility to protect retirement

15. Fiduciary Rulemaking, *supra* n. 1, 81 Fed. Reg. at 20,955.

16. Seth L. Elan, Fed. Research Div., Library of Cong., Financial Literacy Among Retail Investors in the United States 5 (2011), https://www.loc.gov/rr/frd/pdf-files/Investor_Literacy_Report.pdf(finding that many investors do not understand "the most rudimentary financial concepts: inflation, bond prices, interest rates, mortgages, and risk"); *id*. at 25 (finding that investors also do not understand slightly more advanced topics, including "differences between stocks and bonds, the role of the stock market, and the value of portfolio diversification"); Tess & Jill, (finding that subjects did not know to select an otherwise identical investment based on the lowest cost unless specifically instructed to do so).

assets by allowing seemingly harmless word-salad disclaimers to greenlight profiting from shoddy advice.

Moreover, the Department should not allow any financial professional to give substandard or self-serving advice merely because it may not be the "primary basis" for an investment decision. This approach turns investment advice into a predatory trap. Consider one scenario where a retirement saver hears from a friend that the friend's assets have been placed inside some complex annuity contract. The saver may meet with an insurance company's representative to inquire about the product because the friend purchased it. Here, the representative should not be free to give low-quality advice simply because the primary basis for exploring the option was the friend's prior purchase.

Identifying whether financial advice, independent research, or some other reason served as a "primary basis" for an investment decision may be impossible. The persons giving financial advice for a fee should not be able to dispense lower-quality advice on the theory that an investor should not rely on that advice as a primary basis for their investment. Accordingly, PIABA urges the Department to consider replacing the 1975 Regulation with a new regulation that will appropriately protect workers and retirees receiving investment advice and hold those providing investment advice to a true fiduciary standard.

II. The 2020 Proposal Effectively Lowers the Standard of Care Required of Investment Advice Fiduciaries

By reinstating the 1975 Regulation, the Department will ensure that many who should be deemed Investment Advice Fiduciaries will instead be excluded by the regulation. Now, with the 2020 Proposal, the Department is going even further, and *lowering* the standard of conduct for financial firms and professionals that are captured by the regulation from a fiduciary obligation to a "best interest" standard. This represents a dramatic and unprecedented reversal of the intent of Congress in enacting ERISA.

The 2020 Proposal would create a new class exemption allowing Investment Advice Fiduciaries, under both ERISA and the IRC, to receive compensation from third parties in connection with transactions involving pension plans and IRAs, and to engage in principal transactions and other conduct that would otherwise be prohibited transactions under ERISA and the IRC, provided that they comply with certain standards. Investment Advice Fiduciaries would be required to (i) adhere to the "Impartial Conduct Standards;" (ii) provide certain disclosures; (iii) establish, maintain and enforce written policies and procedures designed to ensure compliance with the Impartial Conduct Standards; and (iv) conduct an annual *retrospective* review.[17] However, collectively, these requirements do not ensure that Investment Advice Fiduciaries will be held to fiduciary standards. The requirements do little more than replicate existing standards, standards which are not fiduciary obligations. While the existing standards do not apply to all of the individuals who provide investment advice, and in some cases may raise the applicable standards of care, the Department's goal should not be to make brokerage and investment advisory standards the uniform standard of care. Rather, the Department's goal should be to ensure that the ERISA fiduciary standards become the uniform standard for those providing investment advice to retirement investors. The 2020 Proposal falls far short of that goal.

A. The Impartial Conduct Standards are Flawed

The Impartial Conduct Standards require that the Investment Advice Fiduciary comply with three prongs: (i) provide advice in the investor's best interest; (ii) charge only reasonable compensation and seek best execution; and (iii) make no materially misleading statements about the investment transaction and other relevant matters.[18]

The first prong of the Impartial Conduct Standards, the best interest obligation, is to be interpreted and applied consistent with the best interest standard as defined by the Commission's recently enacted Reg. BI.[19] Unfortunately, in developing its Impartial Conduct Standards, the Department has chosen to rely on a regulation which is not a fiduciary standard. In its enactment of the regulation, the Commission explicitly acknowledged that Reg. BI, while drawing on some principles of fiduciary obligations, was something different.[20]

Reg. BI materially differs from a true fiduciary standard in several respects. Reg. BI does not define what is meant by "best interest," but rather, creates a checklist of four obligations a firm must discharge to meet the standard. Those obligations are: (1) providing certain prescribed disclosures before or at the time of the recommendation about the recommendation and

17. 2020 Proposal, *supra* n. 6, 85 Fed. Reg. at 40,842.

18. *Id.*

19. *Id.*

20. Reg. BI, *supra* n. 3, 84 Fed. Reg. at 33,320.

the relationship between the customer and the broker-dealer; (2) exercising reasonable diligence, care and skill in making the recommendation; (3) establishing, maintaining and enforcing policies and procedures reasonably designed to address conflicts of interest; and (4) establishing, maintaining and enforcing policies and procedures reasonably designed to achieve compliance with Reg. BI.[21]

None of the foregoing obligations actually requires the firm to place the customer's interests ahead of the adviser's.[22] Instead, Reg. BI states that the adviser cannot "place its own interests ahead of the customers' interests. Consequently, Reg. BI allows the adviser to put its own interests on an equal footing with the customers' interests."[23] In baseball terms, a tie goes to the adviser. This is contrary to the fundamental premise of a fiduciary duty: that the investors' interests must always come first. Similarly, the Department has said that the Impartial Conduct Standard will only require that the Investment Advice Fiduciary may not place their interests ahead of the retirement investors' interests.[24] There will not be any requirement that the retirement investors' interests come first.

INVESTORS ARE HARMED WHEN THEIR INTERESTS ARE NOT MADE TO COME FIRST

Bob and Janet met their broker, Shawn, after hearing his radio show. Shawn often talked about alternative investments on his show, touting them as providing safe and secure income without all of the volatility of stocks. As Bob had significant health problems, he was concerned about his ability to provide for Janet into retirement. Bob reached out to Shawn to ask for his help managing the couple's modest savings. Shawn ultimately recommended a number of non-traded REITs and Business Development Companies ("BDCs"). These investments are highly speculative, risky, and illiquid. Shawn presented them as safer and more diverse than the stock market. Shawn did not mention the lucrative fees such investments pay to firms and brokers. These investments often have up-front costs and fees of 10 – 15%, a significant portion of which is passed along to the brokerage firm and its brokers in the form of commissions. It is clear Shawn recommended these products because of the benefits he would receive, not because they were appropriate for Bob

21. *Id.*

22. *Id.*

23. *Id.*

24. 2020 Proposal, *supra* n. 6, 85 Fed. Reg. at 40,843.

and Janet. Shawn knew Bob and Janet were relying on him put Bob and Janet's interests first, but Shawn violated their trust.

The Commission has also made it clear that it will not interpret Reg. BI's non-fiduciary "best interest" standard to require the recommendation of investments which the adviser reasonably believes are the best available option for the investor.[25] Instead, the Commission has interpreted "best interest" in a manner which is virtually indistinguishable from the suitability standard applied to non-fiduciary brokers.[26] It seems the Department will likewise not require that the Investment Advice Fiduciary provide the best advice.[27]

INVESTORS TRY TO MAKE THE RIGHT CHOICES, BUT INVESTMENT ADVICE FIDUCIARIES OFFER CONFLICTED ADVICE, AND THE INVESTORS END UP PAYING THE PRICE

A New Jersey couple in their late forties opened an account with a broker. The couple thought they were doing something responsible to help prepare them for retirement. The broker placed their funds in a combination of private placements, REITs, and other high-risk alternative investments. The broker told the couple the investments were safe and met their goals of preservation of capital and growth. The couple didn't know that, while the investments may have offered some potential for growth, they were highly risky. No doubt, the broker and his firm were not motivated by the interests of their clients, but rather by the substantial fees earned from these investments. Had the broker recommended truly appropriate investments, the broker would have earned much less. Unfortunately, the only person who benefited from this trading was the broker. Meanwhile, the couple lost a significant amount of their retirement savings.

Moreover, the Department has decided that Investment Advice Fiduciaries will be able to provide investment advice despite having a financial or other interest in the transaction.[28] The core fiduciary obligation – the prohibition of conflicts of interest – has been eliminated, and replaced with a lesser standard.

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25. Reg. BI, *supra* n. 3, 84 Fed. Reg. at 33,321.

26. *Id*.

27. 2020 Proposal, *supra* n. 6, 85 Fed. Reg. at 40,843.

28. 2020 Proposal, *supra* n. 6, 85 Fed. Reg. at 40,843.

WHEN INVESTMENT ADVICE FIDUCIARIES HAVE A FINANCIAL INTEREST IN THE RECOMMENDED TRANSACTIONS, THEY MAY BE MOTIVATED TO PROVIDE HARMFUL ADVICE

Tom and Shari were a couple from Kansas. Tom, 71, was working as a facilities engineer. Shari was 69, working as a Program Director for their local church. Tom and Shari were introduced to their broker, Bill, by other members of the church who Bill also advised. Initially, Bill reviewed Tom and Shari's retirement accounts and told them that they were being badly mismanaged, they should sue their old broker, and they should trust his professional management. So, of course, they believed him and transferred their accounts. Over the next five and a half years, Bill excessively traded the accounts. Shari's IRA was worth over $700,000 when it was transferred to Bill. Five and a half years later, it was worth just over $250,000 – a loss of $450,000. Bill earned almost $230,000 in commissions during this time period which accounted for more than half the losses. Tom's IRA was worth just over $250,000 when it was transferred to Bill. At the end, his IRA was worth only $40,000 – a loss of over $200,000. Bill earned $130,000 in commissions on Tom's account. In total, Tom and Shari lost over $600,000 of their retirement funds, while Bill earned $360,000.

Additionally, although a fiduciary usually has the duty to monitor the accounts of its clients (assuming an ongoing relationship), the proposed rule would adopt Reg. BI's approach which does not require monitoring.[29]

The second prong of the Impartial Conduct Standards replicates pre-existing obligations to charge reasonable compensation and seek best execution. For example, investment advisers and brokers both have obligations to charge reasonable fees.[30] Additionally, brokers have an obligation of best execution.[31]

The third prong of the Impartial Conduct Standards prohibits Investment Advice Fiduciaries from making misleading statements. Again, both investment advisers and brokers are already subject to such a prohibition under federal statutes and regulations.[32]

29. Reg. BI, *supra* n. 3, 84 Fed. Reg. at 33,321.

30. *See, e.g.*, SEC, "Regulation of Investment Advisers by the U.S. Securities and Exchange Commission," p. 50 (Mar. 2013), available at https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf; *see also*, FINRA Rule 2121.

31. *See, e.g.,* FINRA Rule 5310.

32. *See, e.g.*, 17 C.F.R. §240.10b-5.

The Impartial Conduct Standards should establish adequate protections to ensure those that are Investment Advice Fiduciaries who will engage in otherwise prohibited transactions do not take advantage of retirement investors. However, the Impartial Conduct Standards do nothing more than articulate standards that already exist in other places. They will not provide retirement investors with the heightened protections those investors are entitled to under ERISA and the IRC. Investment Advice Fiduciaries must be held to a true fiduciary standard and obligated to put the retirement investors' interests first.

B. The Disclosure Obligations are Weak and Duplicative of Existing Law and Regulation

The Department will also require that Investment Advice Fiduciaries acknowledge that they are fiduciaries and provide a written description of the services provided as well as material conflicts of interest arising out of the services and recommendations.[33] Here, again, the Department relies to a large extent on disclosures that Investment Advice Fiduciaries will likely already be making pursuant to other regulatory obligations. For example, brokers and investment advisers must make similar disclosures pursuant to Reg. BI as part of Form CRS.[34] The Department expects that many firms will be able to satisfy their disclosure obligation by relying on the disclosures that will be made in Form CRS.[35]

Moreover, providing disclosure does not adequately mitigate the conflicts of interest inherent in the relationship between Investment Advice Fiduciaries and their clients. Instead, it inappropriately places the burden on the client to fully understand the impact of those conflicts on the future of their retirement savings. Disclosure is particularly meaningless in this context, because many retirement savers are not sophisticated and reasonably rely upon the verbal representations of Investment Advice Fiduciaries.

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33. 2020 Proposal, *supra* n. 6, 85 Fed. Reg. at 40,844.

34. Form CRS, *supra* n. 4, 84 Fed. Reg. at 33,502.

35. 2020 Proposal, *supra* n. 6, 85 Fed. Reg. at 40,853.

DISCLOSURES DO NOT ADEQUATELY INFORM INVESTORS WHO RELY ON THE ADVICE OF THE INVESTMENT ADVICE FIDUCIARY

Paul and Ann are two retirees who lost nearly all of their life's savings after placing their trust in their neighbor, Rick, who was also their broker. Together, Paul and Ann built a nest egg of about $250,000, which they held in bank certificates of deposit – until they met and became friendly with Rick. Rick lived nearby and occasionally helped Paul with difficult tasks around the house. Rick touted his investment expertise and told Paul and Ann that he could invest their savings so that they could earn higher returns than the banks paid. Paul and Ann had no prior investment experience and, trusting their friend and broker, Rick, they signed all the account opening and other paperwork that Rick presented to them. The documents included subscription agreements with boilerplate risk disclosures, but given their trust in Rick, Paul and Ann simply signed and initialed all the documents where indicated. Rick placed all of their savings into four high risk private placements that were being pushed by his broker-dealer and which paid high commissions; one of the issuers was in fact seized by an SEC receiver because it turned out to be a Ponzi scheme.

Disclosure cannot be a substitute for adherence to fiduciary obligations.

DISCLOSURES ARE USED TO PROTECT THE FIRMS, NOT INFORM INVESTORS

Kathy, a recently widowed manufacturing employee who lost her job during the financial crises in 2008, contacted broker Herbert to help her establish an investment plan. Kathy's only assets outside of her modest home were approximately $180,000 of savings in annuities and bank certificates of deposit ("CDs"). Herbert recommended to Kathy that she liquidate the annuities and CDs and trust him to place them in investments that would grow and generate income for her expenses. Instead, Herbert placed nearly half of Kathy's limited savings in a non-traded Real Estate Investment Trust ("REIT") and a high-risk oil and gas limited partnership. Both investments paid significant commissions to Herbert. When Kathy sued, the broker-dealer claimed that Kathy understood the risks because she signed the REIT's subscription agreement with risk disclosures – buried in over 30 pages of documents Herbert had provided to Kathy.

Conflicts of interest that will impact an Investment Advice Fiduciary's ability to put a retirement investor's interests first should be eliminated or mitigated, not simply disclosed. Retirement Investors cannot consent to be harmed, and a true fiduciary would not seek such consent.

C. The Written Policies and Procedures Obligations Should be Stronger

The Department's proposed rule will require that Investment Advice Fiduciaries establish, maintain, and enforce written policies and procedures that are designed to ensure that there is compliance with the Impartial Conduct Standards.[36] Yet again, such a requirement does little beyond what many Investment Advice Fiduciaries are already obligated to do under other regulatory schemes. For example, FINRA registered firms have such an obligation under FINRA Rule 3010. Additionally, the Commission adopted a similar obligation under Reg. BI.[37]

POLICIES AND PROCEDURES ALONE CANNOT PROTECT RETIREMENT INVESTORS

Donna was a 58-year old single person with a high-school education. When her stockbroker of many years transferred her account to another firm, the broker completed the account application paperwork showing Donna as an investor with a six-figure income and extensive investment experience, seeking an aggressive investment strategy, and having a high tolerance for risk. The broker knew none of it was true. Donna signed the paperwork without question or discussion because she trusted her stockbroker. The firm sent her a 40-page "welcome" packet that included her profile information, and informed Donna to contact her broker with questions or corrections. Overwhelmed by the sheer volume, she did not read the false paperwork. After the stockbroker lost most of Donna's money through imprudent, high-risk investments, Donna filed a claim seeking compensation for her losses. The central pillar of the firm's defense was Donna's false customer profile, which the firm argued had given them, in effect, free rein to act contrary to Donna's best interest.

Most importantly, policies and procedures alone are not a substitute for a true fiduciary obligation. Unless the Impartial Conduct Standards require Investment Advice Fiduciaries to adhere to fiduciary standards, the policies and procedures designed to enforce them will necessarily fall short. The

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36. 2020 Proposal, *supra* n. 6, 85 Fed. Reg. at 40,845.

37. Reg. BI, *supra* n. 3, 84 Fed. Reg. at 33,321.

Impartial Conduct Standards must create a culture that the retirement investors' interests should come first. Only then will the supervisory structure be capable of protecting retirement investors.

There is one aspect of the policies and procedures requirement where the Department does go beyond existing requirements. The Department explicitly requires written documentation of the rationale supporting recommendations to roll over Plan or IRA assets to another Plan or IRA, and/or to change from one type of account to another (e.g., from a commission-based account to a fee-based account).[38] PIABA supports this provision and agrees that these two types of investment recommendations are important and should require written documentation.

However, this provision is too narrow as currently written. There are many other consequential recommendations concerning retirement savings which frequently arise in a retirement investor/Investment Advice Fiduciary relationship. Such recommendations include, but are not limited to: (1) advising a client to take a lump cash payment in lieu of a pension plan; (2) advising a client to take an early retirement; and (3) advising a client to use retirement assets to purchase high-cost, high-risk, and/or illiquid products such as indexed annuities, indexed universal life insurance, alternative investments, and/or unsecured promissory notes. These recommendations can, and often do, have devastating consequences for retirement savers.

For example, many older investors seek investment advice as they are considering when to retire and/or whether to take a lump sum payment in lieu of a defined benefit pension. These investors place themselves in what they believe are the capable and trustworthy hands of purported retirement planning experts. By cashing out a defined benefit pension plan, the pensioner forever loses a secure benefit that would have provided a guaranteed lifetime income. Likewise, an individual who retires too early loses the ability to generate sufficient income for retirement, and is often then forced to go back to work for lower pay, or to become dependent upon government assistance. In that regard, it is important to recognize that recommendations to take early retirement, or to elect a lump sum in lieu of a pension, are a necessary precursor to an adviser obtaining control of retirement assets upon which the adviser can earn fees and commissions. As a result, such recommendations should trigger the same documentation requirements as recommendations to rollover an IRA or to convert to a different type of account.

38. 2020 Proposal, *supra* n. 6, 85 Fed. Reg. at 40,845.

ALL RECOMMENDATIONS IMPACTING RETIREMENT SAVINGS ARE CONSEQUENTIAL AND SHOULD BE DOCUMENTED

In the late 1990s and early 2000s, broker SK gave "retirement planning" seminars onsite at Pacific Bell offices throughout Northern California for Pacific Bell retirees who had been offered early retirement packages. At these seminars and in one-on-one meetings which followed the seminars, SK advised the prospective retirees to take the early retirement packages, elect a lump sum payout in lieu of a pension, and invest the lump sums through the broker-dealer with whom she was affiliated. SK told the prospective retirees that her investment prowess would produce an income stream that was larger than their pensions, but just as safe, while also allowing them to leave an inheritance. SK then recommended to the early retirees that they invest those lump sums into variable annuities and earned significant commissions from those sales while losing large sums of those retirees' savings.

Given the foregoing, PIABA believes the documentation requirement should apply to all forms of advice that an investment advisory fiduciary provides with respect to retirement accounts, including, but not limited to, advising a client to take a lump cash payment in lieu of a pension plan; advising a client to take an early retirement; and all investment advice, including advising a client to use monies in a retirement account to purchase indexed annuities, indexed life insurance and/or private placement investments.

III. The 2020 Proposal Should Provide Clearer Standards For When An Investment Advice Fiduciary May Become Ineligible To Act As Such

The 2020 Proposal provides that individuals who have been provided with an ineligibility notice from the Director of the Office of Exemption Determinations would be ineligible to rely upon the exemption for ten years. The foregoing notice would be provided if an individual has: "(i) engaged in a systematic pattern or practice of violating the conditions of the exemption; (ii) intentionally violated the conditions of this exemption; or (iii) provided materially misleading information to the Department in connection with the Investment Professional's or Financial Institution's conduct under the exemption."[39] The foregoing proposal is so vague that it is essentially meaningless and unenforceable.

39. 2020 Proposal, *supra* n. 6, 85 Fed. Reg. at 40,849.

Specifically, the 2020 Proposal does not define what is meant by "systematic," nor how many violations need to occur in order for such violations to become "systematic." The proposal also does not explain what type of violations qualify as "intentional," or what type of information would be considered "materially misleading." The proposal provides no guidance as to the type of circumstances which would cause an Investment Advice Fiduciary to become ineligible to rely on the exemption.

Retirement savers and ethical fiduciaries share a common interest in ferreting out the "bad apples" who abuse their clients' trust. In order for that to occur, there has to be a clear definition of the conduct or type of conduct, and the number of instances of misconduct, that would render an individual ineligible. Other federal regulations, including other regulations promulgated under ERISA, routinely provide such definitions, as well as examples of the type of conduct that would qualify or not qualify. Specificity and clarity are essential in order for investors to have meaningful and enforceable protections from rogue advisers. Clear and specific standards are equally imperative for firms to enforce the rule, and to be able to discharge individuals who violate it.

The proposal also provides the Department with an unfettered amount of discretion to determine what misconduct, and how many instances of misconduct, cause an Investment Advice Fiduciary to become ineligible to rely on the exemption. The proposal, if enacted, would provide the Department with an unprecedented amount of discretion, allow the Department to pick winners and losers among investment advice firms, and deprive Investment Advice Fiduciaries of due process rights to which they are entitled under the Administrative Procedures Act. Certainly, PIABA wants to see bad actors removed from the investment advice business, but creating an unworkable and likely unconstitutional model for doing so means the Department will fail out of the gate to achieve its goal.

For the foregoing reasons, the final rule should clearly and specifically define the types of misconduct, and the number of instances of misconduct, which would render an Investment Advice Fiduciary ineligible to rely upon the exemption. It should also provide for ineligibility to be determined by a fair and neutral administrative process conducted pursuant to the Administrative Procedures Act, rather than by departmental fiat.

IV. ***Conclusion***

In sum, the Department should not reinstate the 1975 Regulation. Rather, the Department should adopt a new regulation which eliminates the need to establish that investment advice has been given on a regular basis, or pursuant to a mutual agreement that the advice will serve as the primary basis for the investment decision. Any individual providing investment advice for a fee should be deemed an Investment Advice Fiduciary and held to the highest fiduciary standards. To the extent the Department establishes a class exemption, such an exemption should not lower the fiduciary obligations of Investment Advice Fiduciaries. Retirement investors deserve to have their retirement savings protected, as was intended by the enactment of ERISA. PIABA urges the Department to adopt standards that go beyond those adopted by the Commission in the enactment of Regulation Best Interest, which the Commission itself conceded was not a fiduciary standard.

Respectfully submitted,
Samuel B. Edwards, President
Public Investors Advocate Bar Association

The following Comment Letter regarding *File No. SR-FINRA-2020-020; Proposed rule change to Adopt FINRA Rule 3241 (Registered Person Being Names a Customer's Beneficiary or Holding a Position of Trust for a Customer)* was submitted to Financial Industry Regulatory Authority by Samuel Edwards on July 30, 2020. (prepared with the assistance of William Young, Darlene Pasieczny and Hugh Berkson).

Ms. Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: SR-FINRA-2020-020; Proposed Rule Change to Adopt FINRA Rule 3241 (Registered Person Being Named a Customer's Beneficiary or Holding a Position of Trust for a Customer)

Dear Ms. Mitchell,

I write on behalf of the Public Investors Advocate Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors in securities disputes. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities dispute resolution forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules promulgated by the Financial Industry Regulatory Authority ("FINRA") relating to both investor protection and disclosure. As such, PIABA frequently comments upon proposed rule changes in order to protect the rights and fair treatment of the investing public.

PIABA submits this comment because the bar association believes the proposed rule is an important and necessary step in fighting a particular form of abuse – where registered representatives take advantage of customers to have themselves installed as the customers' beneficiaries or trustees over the clients' assets. However, PIABA also believes a more uniform approach should be taken as to registered persons' required reporting when such an appointment takes place.

Background

Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (the "'34 Act"), FINRA is filing with the U.S. Securities & Exchange Commission ("SEC" or the "Commission") a proposed rule change to adopt Rule 3241 to provide uniform procedures when a registered person is named a customer's beneficiary or asked to hold a position of trust for a customer. The public comment period runs through July 30, 2020.

Comments

As FINRA notes, conflicts of interest frequently arise in situations where registered representatives are named as beneficiaries or hold positions of trust. Senior and cognitively impaired investors are particularly vulnerable, and problems may not be discovered by family members for years. PIABA members have encountered countless situations when representing investors or investors' families where a registered representative was given effectively complete authority to do with an investor's money or accounts whatever the registered representative wanted with virtually no oversight. This has resulted in many situations where vulnerable investors have been victimized when a trusted advisor invests a client's money in a broker's outside business activity, uses the client's money to invest in high commission products, or, sometimes even simply stealing the client's money. That includes taking a client's money by becoming a beneficiary of the client's estate, which is a crucial issue the proposed rule addresses. Requiring advisors to disclose their interests – whenever they learn of them – will inform the registered person's supervisors of such a relationship and should increase the scrutiny and oversight to which those accounts are subjected. PIABA also sees meaningful benefit in the proposed rules' mandate that a supervising brokerage firm would have more information available when supervising transactions in an account for which the firm is on notice the registered person has a financial interest.

PIABA agrees the adoption of new Rule 3241 creating a uniform, national standard to govern registered persons holding positions of trust will better protect investors and provide consistency across member firms' policies and procedures. However, PIABA believes the proposed rule should go further and also prescribe a uniform written notice provision rather than permitting individual member firms to specify the required form of written notice for its registered persons. Lastly, PIABA agrees that a detailed assessment must be done, upon notification of the registered person's appointment, to determine and assess the potential risks created by the registered person's assuming beneficiary status or acting in a trust capacity. Such review should be mandatory and would add a necessary layer of protection for vulnerable clients and their families.

Conclusion

For these reasons, PIABA supports the increased disclosure and supervisory requirements imposed under proposed FINRA Rule 3241, but we would also like to see uniformity in the notice provisions. The potential for conflicts of interest, when non-immediate family member registered persons are in positions as beneficiaries, trustees, etc. requires as many procedural safeguards as practicable for FINRA to fulfill its stated mission of investor protection.

Respectfully submitted,
Samuel B. Edwards, President
Public Investors Advocate Bar Association

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The following PIABA Comment Letter regarding *NASAA's June 30, 2020 Proposed Model Act to Create a Restitution Assistance Fund for Victims of Securities Violations* was submitted to the North American Securities Administrators Association by Samuel B. Edwards on July 30, 2020. (prepared with the assistance of Hugh Berkson, Darlene Pasieczny, and Albert Copeland).

Karla Black
Chair, Restitution Assistance Working Group
North American Securities Administrators Association

Re: Invitation to Comment Concerning NASAA's June 30, 2020 Proposed Model Act to Create a Restitution Assistance Fund for Victims of Securities Violations

Dear Ms. Black:

I write on behalf of the Public Investors Advocate Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors in securities arbitration and litigation. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities dispute resolution forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in the North American Securities Administrators Association's ("NASAA's") efforts relating to investor protection.

On June 30, 2020, NASAA invited public comment on a Proposed Model Act to Create A Restitution Assistance Fund For Victims of Securities Violations (the "Model Act").[1] PIABA generally supports the Model Act. Unwitting investors come to learn too late that their trusted advisors not only had defrauded them, but also that those advisors lacked the resources to pay restitution amounts ordered by a state securities regulator[2]. A state-sponsored

1. North American Securities Administrators Ass'n, NASAA Seeks Public Comment on Proposed Model Act to Establish Restitution Fund for Victims of Securities Law Violations, News Releases (July 1, 2020), https://www.nasaa.org/55241/nasaa-seeks-public-comment-on-proposed-model-act-to-establish-restitution-fund-for-victims-of-securities-law-violations/?qoid=current-headlines.

2. While not within the scope of this Model Act, and as further discussed herein, PIABA notes the insidious problem of customer arbitration awards against advisors

backstop that provides victims of securities violations with at least some amount of recovery is a welcome and critical addition to available investor protection tools in this country.

PIABA applauds the flexibility built into the Model Act as well as NASAA's explanation of the thought process underlying each proposed term. However, PIABA has several concerns regarding the proposed Model Act. Specifically, our concerns relate to the fund's proposed recovery limits, Section 9's provision authorizing jurisdictions to recover from affected investors paid restitution awards that were overturned on appeal, and the Model Act's shortcomings in addressing the majority of injured investors. We urge NASAA to consider expanding the Prefatory Notes or otherwise revisiting the language of the respective sections in the Model Act, so that states or commonwealths considering adopting a version of the Model Act might weigh the following points and promote enhanced investor protections.

1. The Model Act's Proposed Recovery Limits Will Not Make Investors Whole nor Solve the Financial Distress Defrauded Investors Often Suffer.

The proposed recovery limits of $25,000 (or $50,000 for victims who are statutorily defined "vulnerable persons") are considerable sums in the abstract. But these amounts fall woefully short of making many harmed investors whole again or even helping some investors who were defrauded of all their savings. The Model Act's formula won't make even "smaller" restitution awards fully recoverable to the investor. The payments from the proposed fund would be capped at 25% of the investors' unpaid restitution award. By design, then, the fund will not make an investor whole. No explanation is given why that would be the case for restitution awards less than $25,000 (or $50,000 for vulnerable persons), or why the fund could not be designed to come much closer to ensuring the entirety of unpaid restitution awards are addressed by the fund.

Furthermore, the maximum recovery limits are too low in light of available information and what can be extrapolated regarding average customer losses resulting from securities violations. FINRA has been publishing statistical data concerning unpaid FINRA arbitration awards for some time, and the data

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and firms going unpaid. Like unpaid restitution awards, unpaid arbitration awards effectively re-victimizes the investor who proves their case (in the arbitration forum selected by the advisor) that the advisor's unlawful conduct caused recoverable losses, but are left hanging dry when the advisor avoids or otherwise can't pay the award.

is troubling.[3] Several important measurements – e.g. the absolute value of unpaid arbitration awards, the percentage of awards that go unpaid, and the minimum and median awards unpaid – all share a disturbing characteristic: they all trend upward.

Consider, for example, FINRA arbitration award data from 2018. In that year, the smallest unpaid arbitration award was $25,600, with the median unpaid arbitration award set at $281,264. Understanding that losses suffered by investors pursuing FINRA claims may be different than those of eligible victims making claims on a state's restitution fund, a $25,000 cap on a restitution fund payment would almost certainly not make even the most minimally affected victim whole. When one considers the median unpaid arbitration award is in excess of $280,000, a $25,000 restitution fund payment falls far short of putting the victim back to where they should be. Similarly, a maximum $50,000 recovery from a restitution fund for victims who are "vulnerable persons" - defined by the state to be a person of a certain age, e.g. 60 years of age or older, or a person with a statutorily defined mental or physical condition or otherwise protected under state law – is not enough. PIABA appreciates that the Model Act doubles the proposed cap for these victims. But a harmed investor of retirement age simply does not have the time to "make up" for lost retirement savings. Many vulnerable investors are defrauded of their life savings and providing back a very small portion of those losses will not solve their incredible financial distress. That can mean the difference between a senior living independently thanks to available retirement savings, to instead becoming dependent on Social Security, SSI, Medicaid, public housing benefits, and other social welfare programs. And vulnerable persons of any age with enhanced medical or other personal care needs cannot afford to lose precious resources.

In light of these concerns, PIABA urges NASAA to consider increasing the Model Act's recovery limits, or, at a minimum, stressing in the accompanying materials that jurisdictions considering adopting a version of the Model Act perform their own analyses to determine recovery limits that more closely meet investors' actual losses.

3. We recognize that the statistical likelihood of an arbitration award going unpaid may be different than the likelihood that a restitution order goes unpaid. But we are unaware of data reflecting what percentage of state restitution orders are paid.

2. The Model Act's Section 9 Potentially Risks Further Harm to Affected Investors.

PIABA is concerned that Section 9, which provides that a jurisdiction may recover payments made if the award of restitution is overturned on appeal after payment is made, leaves affected investors at risk of being victimized a second time. Any investor who received a payment while an appeal is pending would spend the money recovered at his or her own peril.

Consider, for example, an investor left destitute because of an advisor's unlawful conduct, with six figure losses of her entire savings that previously provided income to cover her cost of living expenses. A restitution order for her six figure losses goes unpaid. The investor successfully recovers the applicable maximum $25,000 from the restitution fund. The investor then spends the money over the next six months to cover living expenses since she has no other assets to be used for such a purpose. After the money is gone, she finds herself fighting a demand from her jurisdiction for the return of the money based on the results of an appeal of which she has no control. The investor then files bankruptcy thanks to her jurisdiction's prosecution of its claim under Section 9 of the Model Act. Alternatively, an investor who does not want to bear the risk of such an outcome puts the restitution fund money aside, potentially for months or years if the order is appealed to the state's highest court, until she is advised that the restitution order is truly final. There is little benefit to that investor, who has to wait until such time as she can spend the needed money without fear of reprisal.

PIABA acknowledges that this is a difficult balancing act: how to put money in investors' hands quickly at the risk of having to ask for its return, versus making the aggrieved investors wait an indeterminate amount of time to receive their restitution payments. In light of these considerations, PIABA suggests that NASAA modify the Model Act to either: (1) make the payouts only after the restitution award is truly final and non-appealable; or, (2) restrict the jurisdiction's ability to recover funds in the event the underlying restitution order is overturned on appeal.

3. The Model Act Does Not Address the Majority of Affected Investors.

Finally, while PIABA endorses the Model Act's concept, we note that it leaves many investors unprotected. Specifically, the Model Act only protects those cases NASAA members bring for a violation of the jurisdiction's law or regulation. NASAA members' restitution awards dwarf individual investor's FINRA arbitration claims every year. But NASAA members prosecute a very small number of claims identical to those brought by individual investors on their own behalf.

First, PIABA acknowledges that NASAA members do not have the resources to review and investigate every investor's individual FINRA arbitration claim to decide whether to prosecute a similar claim through state regulatory process. Second, while NASAA members prosecute violations of their state statutes and regulations, individual investors take advantage of the more liberal equitable FINRA forum, whereby a violation of a statute or common law is not required to recover.[4] Thus, investors will benefit from the

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4. Ms. Fienberg, formerly the president of NASD Dispute Resolution, was a featured speaker and panelist at the NASAA (North American Securities Administrators Association) presentation entitled "NASAA Listens Forum," held at the National Press Club in Washington D.C. on July 20, 2004. She stated:

In arbitration, in SRO/NASD arbitration, unlike in court, you get an equitable result. You do not have to have a claim that is cognizable under state or federal law. It can be cognizable under NASD rules. So, for example, there's only one cause of action under the federal securities laws, that's 10(B), it's very limited, has a short statute of limitations. The rules that are applied by arbitrators looking for equitable relief are much broader than if they had to strictly follow the law.

(Emphasis added). The import of this statement by the CEO of FINRA-DR is that arbitration is an equitable proceeding, rather than an action strictly governed by law. Indeed, according to Ms. Fienberg, claimants are not even required to have a claim cognizable at law. FINRA's approach to the arbitration process is not radical. Courts have long made clear that arbitrators are not bound by legal technicalities and are free to fashion results based on fairness in light of the facts. For example, as stated in 6 C.J.S. Arbitration §104, "Generally, arbitrators are not obliged to follow strict rules of law in the matter at hand and they are privileged to apply broad principles of justice." See also, for example, National Iranian Oil Company v. Ashland Oil, Inc., (en banc) 817 F.2d 326 (5th Cir. 1987) ("[A]rbitration proceedings are by nature equitable."); Application of Columbia Broadcasting System, Inc., 26 Misc.2d 972, 205 N.Y.S.2d 85 (1960) ("It is the settled policy of our courts to encourage arbitration and to enforce arbitration agreements with a complete relief from legal technicality ...[and]...proper relief is ordinarily granted when the facts warrant regardless of what may have been asked for."); In the Matter of Arbitration Between Stanley J. Staklinski and Pyramid Electric Company, 6 A.D.2d 565, 180 N.Y.S.2d 20 (1958) ("As already pointed out, as embodied in the arbitration statute and as recognized in our highest court, arbitration may provide relief in circumstances and on conditions which even a court has no power to grant."); Harold Rosa v. Transport Operators Co., 45 N.J. Super. 438, 133 A.2d 24 (1957) ("We recognize that an arbitrator does not always decide a case according to strict legal principles, but sometimes according to his own concept of what is just and right, and in such cases the courts will not disturb his decision except for very cogent reasons."); California

Model Act only if their particular securities' seller came across their regulator's radar, the regulator decided to prosecute a claim against them, and the wrongdoing ran afoul of the jurisdiction's law or regulation. The majority of investors pursuing a FINRA arbitration claim would not see any benefit since regulators might never discover their claims, or the claims cognizable in arbitration do not run afoul of the state's particular laws. The resulting pool of investors left out of a recovery in this situation is huge. Using 2018 as an example, FINRA reported that $31 million of the $92 million awarded to investors went unpaid. Only a portion of those unpaid awards would have been related to claims also prosecuted by NASAA members. Thus, only a modest subset of victimized investors stand to benefit from the Model Act's provisions.

Finally, the Model Act's definition of "claimant" and the eligibility standard to apply for and receive a restitution award ("natural person") is too limited. Advisors regularly handle securities accounts and make investment recommendations to: trustees of trusts; attorneys-in-fact under a power of attorney; personal representatives of estates; IRAs and other qualified money accounts; partnerships and other entities; and, for the benefit of protected persons under a conservatorship, guardianship, or other court-appointed fiduciary. The Prefatory Notes do mention that jurisdictions should consider expanding eligibility, but given how common these situations are among the investing public, the Model Act language itself should more clearly and expressly include eligibility for these claimants.

4. A Positive Step Forward, But Still Room for Progress.

While the Model Act is undoubtedly a positive step, and will provide some recovery to harmed investors, PIABA encourages NASAA's members to continue to explore ways to broaden recovery of losses and address unpaid arbitration awards. PIABA's previous reports on the subject have promoted a FINRA-sponsored investor recovery pool for unpaid arbitration awards.[5]

State Council of Carpenters v. The Superior Court of Orange County, 11 Cal.App.3d 144, 89 Cal.Rptr. 625 (1970) ("Arbitrators may base their decisions on broad principles of justice and equity and every intendment of validity must be given the award.").

5. PIABA's first report, Unpaid Arbitration Awards – A Problem The Industry Created – A Problem The Industry Must Fix was published in February 2016, and can be found: https://piaba.org/system/files/pdfs/Unpaid%20Arbitration%20 Awards%20-%20A%20Problem%20The%20Industry%20Created%20%20A%

PIABA asks NASAA to consider proposing a model act creating a state-sponsored investor recovery pool for unpaid arbitration awards, funded by fees paid by all registered securities sellers or advisors.

PIABA again supports the concept underlying the Model Act. We urge NASAA and its members to consider exercising their considerable creative efforts to broaden the scope of any restitution assistance funds, in an effort to protect as many investors as possible.

PIABA thanks NASAA for the opportunity to offer our comments to you.

Respectfully,
Samuel B. Edwards
PIABA President

Cc: Lynne Egan (legan@mt.gov)
NASAA Corporate Office (nasaacomments@nasaa.org)

20Problem%20The%20Industry%20Must%20Fix%20%28February%2025%2C%20 2016%29.pdf.

PIABA's second report, Unpaid Arbitration Awards – The Case For An Investor Recovery Pool, can be found: https://piaba.org/system/files/2018-03/REPORT%20-%20Unpaid%20Arbitration%20Awards%20%28March%207%2C%202018%29.pdf.

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The following PIABA Comment Letter regarding *Public Comment on the NASAA Proposed Model Whistleblower Award and Protection Act* was submitted to the North American Securities Administrators Association by Samuel Edwards on June 30, 2020 (prepared with the assistance of Courtney Werning, Jason Kane and Hugh Berkson).

Ms. Lynne Egan
Chair of the State Legislation Committee
North American Securities Administrators Association
750 First Street NE, Suite 1140
Washington, DC 20002
legan@mt.gov

Re: Public Comment on the NASAA Proposed Model Whistleblower Award and Protection Act

Dear Ms. Egan:

I write on behalf of the Public Investors Advocate Bar Association ("PIABA"), an international, not-for profit, voluntary bar association that consists of attorneys who represent investors in disputes with the securities industry. Since its formation in 1990, PIABA's mission has been to promote the interests of the public investor by, among other things, seeking to protect such investors from abuses in the dispute resolution process, seeking to make the dispute resolution process as just and fair as possible, and advocating for public education related to investment fraud and industry misconduct.

PIABA recognizes the significance of model legislation in promoting reform and uniformity where they are needed. NASAA has had success with previous model acts: for example, 27 states have enacted some form of the 2016 NASAA Model Act to Protect Vulnerable Adults from Financial Exploitation. Through those efforts, NASAA helped broaden and strengthen the protection of our most financially vulnerable population.

PIABA is generally supportive of the NASAA Proposed Model Whistleblower Award and Protection Act ("Model Act"). Our members and their clients have a fundamental interest in advocating the passage of strong, sensible, and consistent state laws that provide a safe environment for whistleblowers to come forward. This in turn will provide regulators with a greater opportunity to stop securities law violations and prevent investors from being harmed. By encouraging states to pass the whistleblower protection and incentives in the Model Act, both PIABA's and NASAA's investor protection missions will be served.

As important as it is to establish incentives and protection for whistleblowers, PIABA has some concern about the practicality of the Model Act when the vast majority of states do not have any established fund to pay the whistleblower rewards, and some states do not allow regulators to assess monetary penalties against wrongdoers. Section 6 of the Model Act provides that any whistleblower awards may be paid from a fund established elsewhere under state law, and each state will need to determine the source of payment of whistleblower awards. Establishment of a robust recovery pool is a critically important first step for states – not just for the Model Act, but for NASAA's investor protection overall.[1] Without that, PIABA worries that the Model Act will not be widely adopted, and NASAA's purpose in putting forth the Model Act will not be served. Regardless of how strong the whistleblower protection rules, regulations, and laws are, they are meaningless absent a whistleblower's ability to actually recover for the risk they have undertaken by reporting the wrongdoing. PIABA urges NASAA to advocate for state creation of investor recovery pools that will allow states to incentivize whistleblowers and protect investors from unscrupulous and uninsured financial professionals.

PIABA also has some concern about the list of disqualifications for receiving whistleblower status under the Model Act – specifically, Section 8(3), which essentially allows for the disqualification of a whistleblower if the information is not submitted in exactly the way the state's securities administrator prescribes. This presents the possibility that a well-intending would-be whistleblower tries to blow the whistle under the Model Act and inadvertently disqualifies themselves because he or she did not follow the exact prescription of steps. This would inadvertently result in disincentivizing whistleblowers from taking the action needed to best protect investors in each state.

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1. PIABA has long been an advocate of investor recovery pools to combat the widespread problem of unpaid FINRA arbitration awards. In the absence of a national recovery pool, states must act individually to protect their citizens – including whistleblowers – by creating dedicated investor protection funds. Three states - Indiana, Montana, and North Dakota - have enacted investor recovery pools that may also be able to fund whistleblower awards. Additionally, Utah and Indiana have funds from which it already pays whistleblowers. The remaining states lack any kind of dedicated fund from which to pay either whistleblower awards or unpaid arbitration awards, a problem that may prevent widespread enactment of the Model Act.

Our members have seen situations where an individual loses Dodd-Frank whistleblower status by making an innocuous and logistical mistake that does not affect the actual delivery of the valuable information to regulators. The rules should be flexible enough to allow state actors to recognize the person who provided the earliest substantive evidence of securities violations and qualify that person under the Model Act. The best sources are likely to be people who did not even think of themselves as whistleblowers or start out on that course of action for financial reward. PIABA urges any states adopting Section 8(3) of the Model Act to establish only easy, clear, and widely advertised steps for an individual to maintain whistleblower status.

Thank you for taking on a task that has very important investor protection implications that may not otherwise exist in certain states. PIABA also thanks you for the opportunity to stay involved on this important matter.

Respectfully submitted,
Samuel B. Edwards, President
Public Investors Advocate Bar Association

cc: Faith Anderson, Chair of the Whistleblower Protections/
Awards Working Group [faith.anderson@dfi.wa.gov]

NASAA Corporate Office [nasaacomments@nasaa.org]

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