No. 07-7080

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

MELANIE SENTER LUBIN,
MARYLAND SECURITIES COMMISSIONER,
Appellant

v.

JOSEPH R. KARSNER, IV, et al.,
Appellees

On Appeal from the District Court for the District of Columbia
(Richard J. Leon, Judge)

AMICUS CURIAE BRIEF OF THE PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION IN SUPPORT OF APPELLANT

C. Thomas Mason III, Esq.
5000 E. Calle Chueca
Tucson, AZ 85718
(520) 299-5900

Kirk Reasonover, Esq.
Reasonover & Olinde, L.L.C.
400 Poydras Street, Suite 1980
New Orleans, Louisiana 70130
(504) 587-1440

Attorneys for Amicus Curiae Public Investors Arbitration Bar Association, Inc.

November 21, 2007

CERTIFICATE AS TO PARTIES, RULINGS AND RELATED CASES

Pursuant to District of Columbia Cir. R. 28(a)(1), counsel for *Amicus curiae* Public Investors Arbitration Bar Association (PIABA), certifies the following:

A. Parties and *Amici*. All parties and *amici* known to PIABA are listed in the Appellant's brief.

B. Rulings Under Review. Appellant seeks review of the district court's minute order denying her motion to intervene in the case, issued on April 9, 2007, by Judge Richard J. Leon. In his motion to dismiss the appeal, Appellee Karsner placed at issue Judge Leon's subsequent order of April 11, 2007, granting Karsner's petition for expungement of his CRD record. This Court directed that the motion to dismiss be addressed in the briefs on the merits. *Amicus curiae* PIABA therefore offers analysis of the standards that Judge Leon should have used—but did not—in reviewing Karsner's petition for expungement. Those standards will be highly relevant if the case is remanded for further proceedings.

C. Related Cases. PIABA understands from the Appellant's brief that there are 12 related cases in the district court, 11 of which are pending before Judge Leon.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, *amicus curiae* Public Investors Arbitration Bar Association is a not-for-profit corporation and does not have any parent entities and there are no publicly held companies that own ten percent or more of its stock.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES

RULES

TREATISES

REGULATIONS

PUBLIC RELEASES

GLOSSARY

CRD	Central Registration Depository system
FINRA	Financial Industry Regulatory Authority (successor to NASD)
Karsner	Appellee, Joseph R. Karsner, IV
Maryland	Appellant, Melanie Senter Lubin, Maryland Securities Commissioner
NASAA	North American Securities Administrators Association
NASD	National Association of Securities Dealers
NTM	Notice to Members (issued by NASD/FINRA)
PIABA	Public Investors Arbitration Bar Association
SEC	U.S. Securities & Exchange Commission

IDENTITY OF *AMICUS CURIAE*, PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION, ITS INTEREST IN THE CASE, AND AUTHORITY TO FILE THIS BRIEF

The Public Investors Arbitration Bar Association, Inc. ("PIABA") respectfully submits this Brief as *Amicus Curiae*. Appellant Melanie Senter Lubin, Maryland Securities Commissioner ("Maryland"), granted consent for PIABA to participate in support of Appellant. In a separate and contemporaneous filing, PIABA respectfully moves for leave from the Court to file this brief.

Founded in 1990, PIABA is a national, non-profit, voluntary, public bar association with a membership of approximately 470 attorneys who devote a significant portion of their practice to representing public investors in disputes against securities brokers or financial advisors and their employers. PIABA members have represented tens of thousands of investors in such disputes.

PIABA's mission is to protect public investors from abuses in and through the securities arbitration forum. PIABA advances the rights of public investors by publishing books and articles on securities law, conducting regular CLE programs, providing comment letters to the SEC, NASD and NYSE (together now FINRA), consulting with securities regulators on rulemaking, and submitting briefs as *amicus curiae*. PIABA has an interest in the outcome of this case because PIABA members represent public investors who have been harmed by improper expungements of customer complaints from their brokers' records or who have

been importuned by brokers in arbitration proceedings who demand expungement as a condition of settling the dispute.

Appellant Maryland has ably argued for review of Judge Leon's refusal to permit Maryland to intervene from the perspective of Fed.R.Civ.P. 24, its property rights in the CRD system, and its regulatory responsibilities. PIABA provides the regulatory history of NASD Rule 2130 (the rule governing expungements at issue in this case), and we show that in promulgating the rule, the SEC and FINRA explicitly gave state regulators the rights and standing to intervene in expungement proceedings such as Mr. Karsner's petitions pending before Judge Leon.

PIABA offers the distinct viewpoint of public investors who are harmed by brokers who successfully white-wash their CRD records and conceal their past misdeeds from the public and arbitration panels. PIABA brings a unique perspective: our members regularly see the damage done to consumers when brokers "buy a clean record" and thereafter continue to prey on the public.

ISSUES PRESENTED

1. Did the District Court err in denying Maryland's motion to intervene? The answer is Yes: FINRA Rule 2130 and its regulatory history expressly empowers states to intervene in expungement proceedings.

2. Did the district court apply the correct standard in granting Mr. Karsner's petition for expungement? The answer is No: The District Judge failed

to assess the facts and merits of the petition, and failed to consider regulatory concerns and investor protection. He mistakenly applied summary confirmation procedures of the Federal Arbitration Act to the arbitrators' *recommendation* for expungement, a recommendation that was not a confirmable award.

SUMMARY OF ARGUMENT

The District Court erred when it ordered expungement of Mr. Karsner's regulatory record. Although the states have a proprietary and regulatory interest in ensuring that complete and accurate records are maintained for all registered brokers, the Court failed to permit state regulators to contest the petition for expungement.

The rules regarding expungement require that brokers go to court when they seek to alter the public record and remove disclosures of prior complaints against them. Court intervention is designed to (1) provide independent scrutiny to any effort to alter public records of securities regulators, and (2) provide a forum involving notice regulators and an opportunity to participate in the protection of the integrity of their records. The District Court erred when it summarily approved expungement, instead of independently scrutinizing the requests, and when it failed to consider the objections of state regulators, who have a proprietary interest in the records and whose oversight is essential to the integrity of the disclosure system.

I. ACCURATE AND COMPLETE CRD RECORDS ARE ESSENTIAL TO INVESTOR PROTECTION

Complete and accurate records in the Central Registration Depository (CRD) are fundamental to the protection of investors and the integrity of the securities industry. The CRD is "used by all the self-regulatory organizations, including the NASD, state regulators, and broker-dealers to monitor and determine the fitness of securities professionals,"[1] and "serves as a vital screening device for hiring firms and the NASD against individuals with 'suspect history.'"[2] It is jointly owned by the North American Securities Administrators Association (NASAA) and FINRA[3], which operates it by agreement.

Brokerage firms and their registered persons (most of whom are commonly called brokers) must provide complete and accurate information to the CRD, and to keep it updated with any material changes. Failure to timely disclose customer complaints and other matters on the CRD violates FINRA Bylaws, NASD rules, and state securities laws and rules. Misrepresentations or omissions in Forms U-4 or U-5, which are the primary source documents for the CRD, are grounds for termination of the person's securities registration. Deliberate misrepresentations

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1 *Rosario R. Ruggiero*, SEC Release No. 34-37,070 (Apr. 5, 1996).

2 *In re Prewitt*, NASD NAC Disciplinary Proceeding No. C07970022 (Aug. 17, 1998).

3 FINRA used to be called NASD before it absorbed the regulatory arm of the New York Stock Exchange in 2007. In this brief, we will use both names, generally using NASD for historical references and FINRA when the issue remains ongoing.

and material omissions to the CRD are federal crimes.[4]

Since FINRA's public disclosure program (now called BrokerCheck) began in 1992, federal and state regulators have promoted the CRD as a valuable source of information for the investing public.[5] SEC Chairman Arthur Levitt stated in testimony to Congress,

> Investor protection also entails helping investors protect themselves. To do so effectively, I believe that investors need information about their registered representative before they open an account. It is essential that an investor be able to choose a registered representative who is trustworthy and reliable.[6]

The SEC tells investors,

> you can find out if brokers are properly licensed in your state and if they have had run-ins with regulators or received serious complaints from investors. You'll also find information about the brokers' educational backgrounds and where they've worked before their current jobs.[7]

FINRA "encourages investors to use this free public disclosure service to learn about the professional background and conduct of the securities firms and

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[4] *U.S. v. Turner*, 22 Fed.Appx. 404, 2001 WL 1216987 (6th Cir. 2001) (applying 18 U.S.C. § 1341, mail fraud, and 18 U.S.C. § 1001, making a false representation to government).

[5] Congress mandated that the NASD publicly disclose the employment and disciplinary history of its members and their associated persons in the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, § 15A(i), now 15 U.S.C. § 78o-3(i). See *Release Of Certain Information Regarding Disciplinary History Of Members And Their Associated Persons Via Toll-Free Telephone Listing*, Release No. 34-30629, 51 S.E.C. Docket 488, 1992 WL 87786 (April 23, 1992).

[6] Testimony of Arthur Levitt, SEC Chairman, before the Subcommittee on Telecommunications and Finance, U.S. House of Representatives (Sept. 14, 1994), 1994 WL 499982, http://www.sec.gov/news/studies/rogue2.txt. (All website URLs in this brief were visited on Nov. 19-20, 2007.)

[7] SEC, "Protect Your Money: Check Out Brokers and Advisers," http://www.sec.gov/investor/brokers.htm.

brokers with whom they plan to do business, or are already doing business. … NASD BrokerCheck should be investors' first stop in choosing a firm or broker."[8]

But the value of the CRD is compromised when prior complaints against the broker have been expunged. Consumers seeking assistance from PIABA members too frequently discover that they had been doing business with recidivists with cleansed records. Forbes magazine reported on one such repeat-victimizer and the huge harm caused to the public:

> Investors in the last seven years have lost some $125 million in a Ponzi scheme allegedly conducted in part by brokers registered with a small California firm headed by Carl Martellaro. What many of those investors didn't know—in fact, couldn't know—was that Martellaro himself had been accused in a similar scheme five years ago. Then, two investors filed complaints claiming they had lost $1.75 million in investments with First Associated Securities Group, of which Martellaro was president. Why didn't investors know that? Because the information had been expunged—legally—from records of the [NASD]. Martellaro's attorney … had offered to settle the earlier cases only if the investors allowed them to be deleted from Martellaro's record with the NASD.[9]

A bad broker can do enormous damage to many people. The fact that bad brokers can continue preying on the public because adverse information was wiped off their records is sufficient evidence that expungements should not be permitted.

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[8] FINRA Press Release, "New, Improved NASD BrokerCheck Goes Live Online Today," March 19, 2007, http://www.finra.org/PressRoom/NewsReleases/2007NewsReleases/p018835. The advice is repeated in FINRA's investor education pages: "FINRA BrokerCheck … should be the first resource investors turn to when choosing whether to do business with a particular broker or brokerage firm." FINRA, Check the Background of Your Investment Professional, http://www.finra.org/InvestorInformation/InvestorProtection/p005882.

[9] Michael Freedman, *The X-ed Out Files*, FORBES, Dec. 25, 2000, http://www.forbes.com/forbes/2000/1225/6616280a.html.

Brokers with multiple customer or regulatory complaints are (or at least should be) put under heightened supervision by their firms, to prevent them from getting into trouble again. "[A] salesman who has previously evidenced misconduct can be retained only if he subsequently is subjected to a commensurately higher level of supervision."[10]

Unwanted scrutiny from superiors and regulators, restraints on moving to another firm, and concerns that clients will discover publicly available adverse information, have led brokers to appreciate the virtues of a clean record. Brokers who are the subject of customer complaints routinely insert demands that the complaints be "expunged" from the CRD into their answers to statements of claim, and misuse settlement negotiations to coerce claimants into granting improper expungements in return for settling the dispute.

Initially, NASD executed the expungements without consulting NASAA, and allowed brokers to emerge with deceptively clean records. Complaints from state securities regulators and PIABA prompted the NASD in January 1999 to impose a moratorium on expungements arising from customer complaints unless

[10] *Dan A. Druz*, 58 S.E.C. 1526, 1528 (1995); accord *Consolidated Investment Services, Inc.*, 61 S.E.C. Docket 19, 23 (1996) ("[The broker-dealer] chose to hire McCormick knowing that there was a pending NASD complaint against him. … Having undertaken to hire and retain such a registered representative, [the broker-dealer] had an obligation to insure that procedures were in place to supervise him properly."). See also Guidance on Heightened Supervision Recommendations, NASD Notice of Members (NTM) 97-19 (April 1997), http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p004826.pdf.

the order to expunge was issued by a court of competent jurisdiction.[11]

NASAA members' concerns were both practical and procedural: Improperly white-washed records deceive the public, and impair states' abilities to perform their regulatory duties. Formally, in many states, the CRD is considered a public or government record. Private arbitrators do not have the authority to order or award the destruction or alteration of a public or governmental record. We will examine the consequences for the present case in Section III.

Expungements also harm subsequent victims of the repeat offender. The void in the record impairs their ability to obtain relevant evidence and prove their own claims against the broker.

Recognizing that arbitrators and settling parties were handing out expungements like candy, NASD undertook to write a rule to confine legitimate expungements within narrowly defined parameters. Its initial proposal was deeply flawed.[12] After reviewing the comment letters, NASD amended the proposal, which the SEC approved in December 2003. The result is NASD Rule 2130, which we provide in its entirety for your convenience:

> **Rule 2130. Obtaining an Order of Expungement of Customer Dispute Information from the Central Registration Depository (CRD System)**

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[11] NASD Regulation Imposes Moratorium on Arbitrator-Ordered Expungements of Information from the Central Registration Depository, NTM 99-09 (Feb. 1999), http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p004582.pdf.

[12] See C. Thomas Mason III, *CRD Expungement: Law, Proposed NASD Rules, and Lawyer Ethics*, 9.4 PIABA B. J. 76 (Winter 2002) (hereafter "C. Thomas Mason III, *CRD Expungement*"). A number of criticisms in this analysis remain applicable to the present rule.

(a) Members or associated persons seeking to expunge information from the CRD system arising from disputes with customers must obtain an order from a court of competent jurisdiction directing such expungement or confirming an arbitration award containing expungement relief.
(b) Members or associated persons petitioning a court for expungement relief or seeking judicial confirmation of an arbitration award containing expungement relief must name NASD as an additional party and serve NASD with all appropriate documents unless this requirement is waived pursuant to subparagraph (1) or (2) below.

(1) Upon request, NASD may waive the obligation to name NASD as a party if NASD determines that the expungement relief is based on affirmative judicial or arbitral findings that:

(A) the claim, allegation or information is factually impossible or clearly erroneous;

(B) the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds; or

(C) the claim, allegation, or information is false.

(2) If the expungement relief is based on judicial or arbitral findings other than those described above, NASD, in its sole discretion and under extraordinary circumstances, also may waive the obligation to name NASD as a party if it determines that:

(A) the expungement relief and accompanying findings on which it is based are meritorious; and

(B) the expungement would have no material adverse effect on investor protection, the integrity of the CRD system, or regulatory requirements.

(c) For purposes of this rule, the terms "sales practice violation," "investment-related," and "involved" shall have the meanings set forth in the Uniform Application for Securities Industry Registration or Transfer ("Form U4") in effect at the time of issuance of the subject expungement order.[13]

Rule 2130 applies to Mr. Karsner's expungement requests. Regardless of what FINRA considered in waiving participation in the expungement process in this case (and the record is bare on that question), the inquiry does not end with FINRA. Affected state regulators must be allowed to participate.

[13] http://finra.complinet.com/finra/display/display.html?rbid=1189&element_id=1159000478.

II. STATES' INTERVENTION IN EXPUNGEMENT PROCEEDINGS

A. STATES HAVE THE RIGHT TO INTERVENE IN COURT EXPUNGEMENT PROCEEDINGS

State regulators have the right to intervene in court proceedings when an associated person seeks expungement of his or her CRD record. The system for expunging CRD records that the SEC approved in December 2003 explicitly provides that states will get notice of expungement requests and will have the right and prerogative to oppose the petition in court.

In Amendment 2 to then-proposed Rule 2130, NASD told the SEC,

> The proposed rule gives NASD and the States the opportunity to participate in judicial proceedings and make the courts fully aware of investor protection and regulatory concerns relating to inappropriate expungements. … NASD's and the States' opportunity to participate in the court confirmation proceedings is an additional safeguard to ensure that courts are aware of the standards under which NASD has agreed to expunge customer dispute information.[14]

The SEC approved the rule with that amendment and pursuant to NASD's comments and analysis.[15] The SEC wrote,

> As a further means to ensure that the court is made aware of the investor protection and regulatory implications of an expungement, NASD noted that states will be able to intervene if they have concerns regarding whether investor protection or regulatory issues have been fairly considered by the NASD.[16]

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[14] Amendment No. 2 to Proposed Rule 2130 Governing Expungement of Customer Dispute Information From the Central Registration Depository, File No. SR-NASD-2002-168 (Sept. 11, 2003), pp. 5-6, http://www.finra.org/web/groups/rules_regs/documents/rule_filing/p001019.pdf.

[15] Exchange Act Release No. 34-48933, 68 F.R. 74667 (Dec. 24, 2003) (granting approval of proposed Rule 2130 and "accelerated approval to Amendment No. 2").

[16] *Id.*, 68 F.R. at 74671.

Courts have held that NASD commentary interpreting its rules and rule proposals deserves judicial deference:

> [B]road latitude should be given to a self-regulatory body in the determination of its rules. Deference is particularly appropriate since the statute requires that the Securities and Exchange Commission review the rules of a self-regulatory body such as the NASD and the SEC has approved the [] rule of the NASD.[17]

FINRA has repeatedly affirmed that it will timely notify the states of expungement requests so the states can appear in court and oppose the petition. NTM 04-16 informs member firms that when FINRA receives a request to waive FINRA's court participation, FINRA "will notify the States where the individual is registered or seeking registration of the expungement notice/waiver request."[18] FINRA's accompanying press release to the public stated,

> NASD will notify state regulators when it is named as a party or receives a waiver request at which time they may decide to join the proceedings and oppose the expungement.
>
> "NASD believes that this approach provides investors, regulators, and brokerage firms with important information while providing a narrowly defined means of permitting individuals to remove inaccurate data from their registration record," said Douglas Shulman, NASD's President in charge of regulatory services, information and markets.
>
> The SEC, in approving the rule, noted that it "strikes the appropriate balance between permitting members and their associated persons to remove information from the CRD system that holds no regulatory value, while at the same time preserving information that is

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[17] *First Heritage Corp. v. NASD*, 785 F.Supp. 1250, 1251 (E.D.Mich. 1992) (internal citation omitted); *Littman v. Morgan Stanley Dean Witter*, 337 N.J.Super. 134, 143, 766 A.2d 794, 799 (N.J.Super. 2001) (same).

[18] Expungement, NTM 04-16 (March 2004), p. 210, http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p003235.pdf.

valuable to investors and regulators."[19]

In its "Rule 2130 Frequently Asked Questions" providing guidance on the expungement process, FINRA reiterates that states will receive notice of expungement requests and informs members that "States that are notified by FINRA will make their own determination on whether to oppose the expungement."[20] States' rights to oppose expungement and the policy reasons for states' participation are clearly spelled out in FAQ 9:

> **9. What is the reason for FINRA, and possibly State, participation in court confirmation proceedings?**
>
> FINRA and State participation in the court confirmation proceeding is an additional safeguard to ensure that courts are aware of the standards of Rule 2130 and relevant regulatory and investor protection interests. There is currently no procedure in place to ensure that courts are made aware of the investor protection, public policy, and regulatory considerations implicated by expungement of customer dispute information. Although courts are not obligated to adhere to the standards enunciated in Rule 2130, the Rule gives FINRA and the States the opportunity to participate in the court confirmation process and make courts fully aware of investor protection and regulatory concerns relating to inappropriate expungements.

FAQ 13 adds that the states' opposition need not mirror FINRA's criteria:

> As a further means to ensure that the court is made aware of the investor protection and regulatory implications of an expungement, States may choose to intervene if they have concerns regarding whether investor protection or regulatory issues will be fairly

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[19] NASD Announces Rule Limiting Expungement of Customer Dispute Information From The Central Registration Depository, March 4, 2003, http://www.finra.org/PressRoom/NewsReleases/2004NewsReleases/P002848.

[20] FAQ 8, Rule 2130 Frequently Asked Questions, http://www.finra.org/RegulatorySystems/CRD/FilingGuidance/p005224.

considered.

The district court erred in not giving effect to Maryland's explicit right to intervene in the proceedings and oppose the expungement request.

B. STATE INTERVENTION IS APPROPRIATE AND NECESSARY TO PROTECT THE PUBLIC

Critics of NASD's proposed expungement process expressed grave concerns about NASD's willingness and ability to oppose expungement requests in court and thereby protect the public.

> The NASD's ability to police the proposed rule is very seriously in doubt. The NASD claims that it can oppose expungement confirmation proceedings in court whenever the basis for the expungement does not satisfy NASD's review. There are huge problems with this. First, NASD legal staff is already overwhelmed and does not have the resources to investigate hundreds of expungement orders. NASD's response in its rule filing was not to assure the public that it will beef up its legal staff to deal with the influx of extra work, but to offer the securities industry more ways to get the NASD to waive its opposition. Second, the NASD does not make any provisions for adequate legal staffing that it will need to appear in hundreds of court proceedings around the country to oppose confirmation and protect the CRD.[21]

Those fears have proven accurate. FINRA has been utterly supine regarding expungement requests. We are unaware of any court proceedings prior to this appeal in which FINRA has actively opposed an expungement request where the award or stipulation facially recited one of the criteria in Rule 2130. FINRA has consistently granted waiver requests, instead of vigorously investigating the

[21] Comments of C. Thomas Mason III, File No. SR-NASD-2002-168 (March 31, 2003), http://www.sec.gov/rules/sro/nasd2002168/ctmason033103.htm.

underlying facts and aggressively opposing improper expungements. It rubber-stamped Mr. Karsner's multiple requests, even though the sheer number of them alone should have raised red flags and provoked diligent inquiry.

1. *Stipulated awards are rife with abuse*

FINRA's neglect is particularly egregious in the case of "stipulated awards." In a stipulated award, the parties settled their dispute privately, presented a joint statement to the arbitrators, and the arbitrators incorporated the statement into their award. In recent years, an overwhelming number of stipulated awards contain provisions for expunging the broker's CRD record.

Abuses in stipulated expungements have long been a source of concern for FINRA, NASAA, and PIABA. In September 2000, PIABA called on the NASD to "ban orders of expungement based upon the agreement of the parties in a settlement…."[22] PIABA analyzed over 300 expungement awards between April 1998 and July 2000, and found that "brokers were buying a clean record."

NASAA wrote that CRD records "were being expunged by agreement of the parties in *quid pro quo* settlements. Whether an agent was able to have his record expunged was often a matter of having a clever lawyer rather than the merits of the complaint."[23] NASAA urged safeguards "to dissuade the practice of plaintiffs and

[22] Investors' attorney group calls upon regulators to change system of "white-washing" brokers' records, Oct. 4, 2000, https://secure.piaba.org/piabaweb/html/modules.php?op=modload&name=Sections&file=index&req=viewarticle&artid=54&page=1.

[23] Comments of NASAA, File No. SR-NASD-2002-168 (June 4, 2003), p. 2.

NASD members from inappropriately bartering away the record of the complaint in a cash settlement."[24]

NASD agreed with these concerns and expressed its belief that Rule 2130 would "reduce, if not eliminate, the risk of expunging information that is critical to investor protection and regulatory interests as a condition in settlement negotiations."[25] That belief was quickly proven wrong. Shortly after Rule 2130 took effect, NASD was shown that

> claimants and respondents appear to be settling customer claims for monetary compensation to the claimant in return (at least in part) for a customer affidavit that absolves one or more of the respondents of responsibility for any alleged wrongdoing. These affidavits, attested to in connection with settlements that often are incorporated into stipulated awards, appear to be inconsistent on their face with the initial claim and terms of the settlement.
> NASD cautions its members and their associated persons that when they submit affidavits in which the content is the product of a bargained-for consideration as opposed to the truth, members and/or their associated persons subject themselves to a panoply of applicable sanctions, including possible disciplinary action for violation of NASD Rules, including Rule 2110, and other penalties, including possible criminal sanctions.[26]

The prohibition is not limited to "affidavits" but includes all statements that "falsely or misleadingly repudiate or otherwise contradict prior claims or

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[24] *Id*. at p. 3.
[25] Amendment No. 2 to Proposed Rule 2130, *supra* fn. 14, at p. 6.
[26] Expungement: Members' Use of Affidavits in Connection with Stipulated Awards and Settlements to Obtain Expungement of Customer Dispute Information under Rule 2130, NTM 04-43 (June 2004), http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p003015.pdf, p. 2.

complaints made by such customers."[27] "[I]n connection with settling arbitration claims and/or other complaints, members may not engage in any conduct that impedes the ability of NASD or any other securities industry regulator to investigate potential violations of NASD rules or the securities laws." *Id*.

Notwithstanding these admonitions, buying stipulated expungements (like buying indulgences in medieval times) continues at high rates. FINRA has made stern pronouncements, but has not followed up with appropriate enforcement against abuses or genuine opposition to improper expungement requests.

Respondents and their counsel blithely ignore FINRA's pronouncements and continue to demand expungement as a condition of settlement. Claimants' attorneys find themselves between a rock and a hard place. They would like to protect the public against predatory or incompetent brokers. But when they are faced with a settlement offer that will satisfy their present client, they cannot ignore their professional obligations to that client.[28] The result is a continuing flow

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[27] *Id*., p. 4 n. 6. FINRA also refers its members to the companion notice, Settlement Agreements: Impermissible Confidentiality Provisions and Complaint Withdrawal Provisions in Settlement Agreements, NTM 04-44 (June 2004), http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p003012.pdf. That notice reiterates, "It is impermissible, as a condition to settling a customer complaint, for a member to require a settling customer or other person to provide an affidavit or other statement that contains false or otherwise misleading or inaccurate information concerning the facts underlying the customer's complaint." *Id*., p. 3.

[28] PIABA does not condone, in any way, actions that falsify a public record or falsely withdraw claims against the broker so as to meet the expungement criteria. Claimants' representatives are urged to "just say No" to expungement demands. See Steven B. Caruso, *Expungement Requests In Settlement Negotiations: Consequences If You Don't Just Say No*, 14.2 PIABA B. J. 3 (Summer 2007); C. Thomas Mason III, *CRD Expungement: Law, Proposed NASD Rules, and Lawyer Ethics*, 9.4 PIABA B. J. 76 (Winter 2002), esp. pp. 96-97.

of hundreds of stipulated awards containing expungement clauses.

A recent empirical study of stipulated awards in 2006 found that "expungements were granted in more than 98% of all of the stipulated or settled arbitration awards where the expungement relief had been requested."[29] In more than 71% of the stipulated awards, "arbitrators were permitted to recommend the expungement of customer complaints [] without any indication of an evidentiary hearing having been held." *Id.* This is contrary to FINRA's arbitrator training materials and nullifies assurances that the SEC relied on in approving the rule. NASD assured the SEC that "the 'affirmative determination' requirement should foil efforts to 'buy a clean record'" and promised that "its arbitrator training materials will make clear that an expungement order must be premised on an *affirmative determination* by the arbitrator…."[30] The empirical facts show that FINRA's arbitrator training is ineffective and its oversight of stipulated awards is essentially nonexistent.

Moreover, "in calendar year 2006, there was one particular broker (Joseph Karsner) who had received 18 separate recommendations, by 18 separate

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[29] PIABA Releases Study And Calls On SEC & FINRA To Halt Arbitrator-Recommended Expungements Of Customer Dispute Information From The Central Registration Depository Records System, Sept. 24, 2007, https://secure.piaba.org/piabaweb/html/modules.php?op=modload&name=Sections&file=index&req=viewarticle&artid=500&page=1, and https://secure.piaba.org/piabaweb/html/modules/ContentExpress/img_repository/ExpungementStudy09242007.pdf. PIABA analyzed all 200 of the stipulated awards entered during 2006, and found that expungement was granted in 182 of the 185 instances in which it was requested.

[30] 68 F.R. at 74670 (emphasis by the SEC).

arbitration panels, of the expungement of the customer complaints and/or arbitration claims that had been asserted against him." The study concluded that "under the current system, critical information that public investors need when they are deciding whether to conduct business with a financial broker, is being improperly concealed from them." *Id*.

2. *Joseph Karsner is a prime example of expungement abuse*

Mr. Karsner is a prime example—a "poster child"—of these abuses. Mr. Karsner used stipulated awards as his mechanism to get rubber-stamped recommendations for expungement. He has settled some two dozen claims brought by his former clients, paying out over $1.1 million in compensation to them. In at least 18 complaints that we know of, he bought the claimant's acquiescence to his expungement demand. In doing so, he repeatedly violated NTM 04-43 and NTM 04-44.

Mr. Karsner wants now to whitewash his dirty professional record. There are few brokers less deserving of that privilege. In September 2003, NASD proposed to enhance heightened supervision over problem brokers—people with 3 or more customer complaints within a 5 year period. NASD examined CRD records and found that 3.3% of the 663,000 registered persons had 1 complaint in 5 years. Only 0.41% of all registered persons had three or more complaints.[31] Mr.

[31] Supervision Rules, NTM 03-49 (Sept. 2003), p. 512.

Karsner has at least 26 customer complaints within 5 years!

Unless state regulators are allowed to step in and fill the void, no one is guarding the accuracy of records of complaints of brokers' misconduct. FINRA has turned a blind eye to stipulated awards where expungement may be a *quid pro quo* for monetary settlement, and where arbitrators failed in their duty to hold an evidentiary hearing regarding the merits of expungement. FINRA has shamelessly rubber-stamped requests even in cases as blatantly abusive as Mr. Karsner's.

Granting Maryland's motion to intervene is proper under FINRA Rule 2130 and Fed.R.Civ.P. 24. State regulatory intervention is appropriate and necessary for the protection of unsuspecting investors.

III. INSTRUCTIONS ON REMAND

Two days after the district judge improperly rejected Maryland's motion to intervene, he granted Mr. Karsner's petition to confirm the stipulated award. In doing so, the judge used the wrong criteria to grant expungement. Since he has numerous other Karsner cases on his docket and may be rehearing this matter after remand, it is important that this Court give the judge—and other judges that may face similar petitions—guidance on the correct standards to use.[32]

Mr. Karsner argued in his Amended Petition,

[32] Our careful review of other jurisdictions through Westlaw indicates that articulating the proper standards is a matter of first impression. It is therefore all the more important for the Court to address the issue and give guidance.

> The confirmation of an already-entered Stipulated Award is perfunctory, a summary proceeding that makes what is already a final arbitration award a judgment of the court. Indeed, the ability of the court to do anything other than confirm a Stipulated Award is strictly curtailed so as not to frustrate the reason for arbitration, namely the disposition of cases quickly and efficiently. In this case, all of the conditions precedent for a confirmation of the attached Stipulated Award are present.[33]

Judge Leon accepted these arguments without review or analysis. He made no findings of fact or law. His Order adopts Mr. Karsner's form without alteration and states only that the Amended Petition to Confirm Arbitration Award is granted and the stipulated award is confirmed.

But Mr. Karsner failed to tell Judge Leon that the court's review of an expungement recommendation is not a typical confirmation proceeding under the Federal Arbitration Act (FAA). A court's review of an arbitration award is limited when presented pursuant to the FAA, 9 U.S.C. § 9.[34] However, arbitrators' recommendation of expungement is not an award—it is a mere *recommendation* that the court may consider in making its *de novo* determination of whether the applicable standards for expungement have been met.

The reason is simple: Arbitrators do not have the power to alter state records. The CRD is an official government record in many states. In the most populous state, for example, Cal.Gov.Code § 6254.12 declares unambiguously:

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[33] District Court Docket # 5, ¶¶ 10-12 (citations to out-of-circuit decision omitted).

[34] *LaPrade v. Kidder, Peabody & Co., Inc*., 246 F.3d 702, 706, 345 U.S.App.D.C. 358, 362 (D.C.Cir. 2001).

> Any information reported to the North American Securities Administrators Association/National Association of Securities Dealers' Central Registration Depository and compiled as disciplinary records which are made available to the Department of Corporations through a computer system, shall constitute a public record.[35]

FINRA wrote that "state laws do not currently recognize the authority of arbitrators to expunge a state record or do not otherwise currently permit such expungements because of state recordkeeping requirements."[36]

Since arbitrators don't have the power to alter or destroy state records, their mere *recommendation* to expunge in any award (stipulated or otherwise) cannot be summarily confirmed under the FAA's standards and procedure. The court cannot rely solely on the bare stipulation that emerged from the settlement. Otherwise, the requirement of judicial review is eviscerated and the judiciary becomes just another rubber-stamp – instead of a protector of a critical resource in law enforcement and investor protection.

The courts have the power and the responsibility make an independent evaluation of the facts of the case, the criteria of Rule 2130, and most importantly, "the investor protections and regulatory concerns relating to inappropriate expungements."[37] In doing so, each judge must satisfy himself or herself that

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[35] For further discussion, see C. Thomas Mason III, *CRD Expungement*, pp. 87-89.

[36] NASD Regulation Imposes Moratorium on Arbitrator-Ordered Expungements of Information from the Central Registration Depository, NTM 99-09 (Feb. 1999), p. 47, http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p004582.pdf.

[37] Rule 2130, FAQ 9, supra n. 20. FINRA recognizes that Rule 2130 is not binding on the courts. *Id*.; see also C. Thomas Mason III, *CRD Expungement*, pp. 85. However, the rule's

destruction of public records and concealment of customer complaints is justified.

A clear principle emerges from the rulemaking process and FINRA's pronouncements and interpretations: "**expungement of a CRD record under any circumstances is an extraordinary remedy and should be used only when the expunged information has no meaningful regulatory or investor protection value.**"[38] The SEC wrote in approving Rule 2130 that the expungement process allows registered persons only to "remove information from the CRD system that holds no regulatory value, while at the same time preserving information on the CRD system that is valuable to investors and regulators."[39]

Mr. Karsner, with 26 customer complaints and some 18 or more stipulations for expungement in exchange for money, cannot plausibly claim that he deserves such an "extraordinary remedy" and that the information he seeks to expunge "has no meaningful regulatory or investor protection value." The District Court did not evaluate any of those considerations. This Court should provide needed instruction that those criteria are required components in the mandatory judicial review of expungement petitions.

CONCLUSION

The rulemaking history of NASD Rule 2130 with the SEC, and FINRA's

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criteria and considerations of investor protection should strongly inform the court's analysis.

[38] Rule 2130, FAQ 18, supra n. 20; also Amendment No. 2, p. 8, and elsewhere.

[39] 68 F.R. at 74672.

pronouncements and interpretations, demonstrate beyond doubt that the states have the right to intervene in proceedings such as this one to protect their citizens and their regulatory interests. State securities regulators are in a unique and important position to evaluate whether a proposed expungement meets the obligations and interests of their own CRD systems.

Nothing in the rule, its history, and its interpretations remotely suggests that FINRA was to have sole discretion as to whether a proposed expungement would be rubber-stamped or opposed. Yet if the states are not allowed to intervene in this and similar cases, FINRA will be left as the sole arbiter with authority to ensure the integrity of each state's records concerning securities brokers doing business with its citizens. Such an anomalous result was never intended by the SEC, FINRA, NASAA, or the individual states.

The CRD system is an essential tool for protecting the public when they invest. But it works properly only if the information it contains is complete and accurate. Permitting multiple-offender brokers like Mr. Karsner to buy expungement recommendations with settlement payments and thus white-wash their professional records is contrary to the purpose of Rule 2130 and contrary to the public interest.

Courts reviewing expungement petitions must recognize that the arbitrators can only make *recommendations*, and that such a *recommendation* is not a

confirmable award under FAA procedures. The district judge must decide if destruction of the public record and concealment of the customer complaint(s) are justified. The district court has the duty to make an independent determination after evaluating the facts of the case, the criteria of Rule 2130, and most importantly, considerations of investor protection and regulatory concerns of inappropriate expungements.

Respectfully Submitted,

C. Thomas Mason III, Esq.
5000 E. Calle Chueca
Tucson, Arizona 85718
(520) 299-5900
and
Kirk Reasonover, Esq.
Reasonover & Olinde, L.L.C.
400 Poydras Street, Suite 1980
New Orleans, Louisiana 70130
(504) 587-1440
Attorneys for Amicus Curiae Public Investors Arbitration Bar Association, Inc.

CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7)(C) and D.C. Cir. R. 32(b), I certify that this brief complies with the type-volume limitation in Fed. R. App. P. 32(a)(7)(B). The word processing system used to prepare this brief reflects that, excluding the portions of the brief Fed. R. App. P. 32(a)(7)(B)(iii) does not require to be counted, the brief contains 5,971 words.

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C. Thomas Mason III, Esq.

CERTIFICATE OF SERVICE

I certify that on November 21, 2007, two copies each of the Brief of *Amicus Curiae* in Support of Appellant were mailed first-class, postage prepaid, to:

Kelvin M. Blake & Lucy Cardwell
Assistant Attorneys General, Maryland Securities Division
200 St. Paul Place, 25th Floor
Baltimore, Maryland 21202
Counsel for Appellant Melanie Senter Lubin, Securities Commissioner

Richard Magid
Whiteford, Taylor & Preston
7 Saint Paul Street
Baltimore, MD 21202
Counsel for Appellee Joseph R. Karsner, IV

Terri L. Reicher
FINRA
1735 K Street, NW
Washington, DC 20006
Counsel for Appellee FINRA (formerly NASD)

William B. Young, Jr.
Colling, Gilbert, Wright & Carter
2301 Maitland Center Parkway, Suite 240
Maitland, FL 32751
Counsel for Appellee Pamela Lothian

_____
C. Thomas Mason III, Esq.

APPENDIX

For the Court's convenience, we are attaching in this appendix the two articles from the PIABA Bar Journal that were cited in the brief. We recognize that they might otherwise be difficult to access.

C. Thomas Mason III, *CRD Expungement: Law, Proposed NASD Rules, and Lawyer Ethics*, 9.4 PIABA B. J. 76 (Winter 2002)

Steven B. Caruso, *Expungement Requests In Settlement Negotiations: Consequences If You Don't Just Say No*, 14.2 PIABA B. J. 3 (Summer 2007)

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CRD Expungement: Law, Proposed NASD Rules, and Lawyer Ethics

C. Thomas Mason, III[1]

C. Thomas Mason, III is a PIABA member residing in Tucson, Arizona. Mr. Mason is on the PIABA Board of Directors. He may be reached at 520.299.5900 or ctm@ctmason.com.

Introduction

The NASD wants to bring expungement[2] back with expanded breadth, posing huge dangers for public investors. This article explores the NASD's new proposed rule permitting expungement, what it means for arbitration procedures and settlement, and your ethical responses when the respondents come knocking with expungement demands.

Through expungement, associated persons[3] and broker-dealers can totally erase adverse entries from their permanent licensing file. Expungement may be an essential element in maintaining accurate records in the Central Registration Depository (CRD). It is also a technique that has been seriously abused by industry respondents, often with the complicity or agreement of claimants' counsel.

Operated by the NASD and jointly administered with NASAA,[4] the CRD is the primary resource for state and federal securities regulators and SROs for licensing and registration. Since the NASD's Public Disclosure Program began in 1992, regulators have promoted the CRD as a valuable source of information for the investing public.[5]

For instance, you can find out if brokers are properly licensed in your state and if they have had run-ins with regulators or received serious complaints from investors. You'll also find information about the brokers' educational backgrounds and where

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[1] 2003 by C. Thomas Mason III. I wish to thank Scot Bernstein for his many useful thoughts in improving this article. I appreciate the willingness of several present and former state securities administrators to speak with me. I also want to acknowledge Larry Schultz, of Driggers, Schultz & Herbst (Troy, Michigan), and Chuck Austin (Richmond, Virginia), for their diligent and dogged efforts opposing expungement and uncovering industry practices. The faults in this article and views I express here are my own, and do not necessarily reflect the positions of PIABA or its board of directors.

[2] To 'expunge' means 'to destroy; blot out; obliterate; erase; efface designedly; strike out wholly. The act of physically destroying information ... in files, computers, or other depositories.'" *Snyder v. City of Alexandria*, 870 F.Supp. 672, 683 (E.D.Va. 1994) (quoting BLACK'S LAW DICTIONARY 522 (5th ed.1979)).

[3] "Associated person" is the official title of all persons who are, anticipate being, or should be registered with the NASD. NASD, Inc. By-Laws, Art. I, para. (ee); NASD Rule 1011(b). Most, but not all, associated persons are the folks we commonly refer to as registered representatives or stockbrokers.

[4] Organized in 1919, the North American Securities Administrators Association "is the oldest international organization devoted to investor protection. It is a voluntary association whose membership consists of 66 state, provincial, and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, Canada, and Mexico." NASAA, http://www.nasaa.org/nasaa/abtnasaa/overview1.asp; NASD News Release, October 2, 2002, http://www.nasdr.com/news/pr2002/release_02_049.html (All websites cited in this article were visited between January 2 and 15, 2003.)

[5] Congress mandated that the NASD publicly disclose the employment and disciplinary history of its members and their associated persons in the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, section 15A(i), now 15 U.S.C. § 78o-3(i). It required the NASD to "establish and maintain, within one year of its enactment, a toll-free telephone listing to receive inquiries regarding actions involving its members and their associated persons and promptly respond to such inquiries in writing." *Order Approving Proposed Rule Change Relating To Release Of Certain Information Regarding Disciplinary History Of Members And Their Associated Persons Via Toll-Free Telephone Listing*, Release No. 34-30629, 51 S.E.C. Docket 488, 1992 WL 87786 (April 23, 1992). The NASD did not enter into the public disclosure program voluntarily or out of the goodness of its heart.

> they've worked before their current jobs.[6]

SEC Chairman Arthur Levitt stated in testimony to Congress,

> Investor protection also entails helping investors protect themselves. To do so effectively, I believe that investors need information about their registered representative before they open an account. It is essential that an investor be able to choose a registered representative who is trustworthy and reliable.[7]

The NASD brags that the online Public Disclosure Program "is the #1 resource tool for the general public and private investors for information about brokers, now receiving over 2.4 million searches per year and responding to most of them within minutes."[8]

However, the securities industry has undermined the CRD's accuracy and reliability by getting accurate material data expunged from the record. Industry respondents have heavily abused expungement in recent years. They have routinely inserted demands for wiping CRD records clean into their answers to statements of claim, and misused settlement negotiations to coerce claimants into granting improper expungements in return for settling the dispute.

Complaints about these abuses from state securities regulators and investors' lawyers prompted the NASD in January 1999 to impose a moratorium on expungements arising from customer complaints unless the order to expunge was issued by a court of competent jurisdiction.[9] The securities industry vigorously opposed the restriction. Impelled by industry demands to broaden the ability to expunge brokers' records, the NASD undertook a multi-year effort to develop a rule or interpretation permitting expungement. This culminated in a formal rule filing advocating broad latitude for expungement. The NASD's proposed Rule 2130 went to the SEC in mid-November 2002 for publication in the Federal Register and comment through the SEC's public rule-making process.[10]

This article will demonstrate why Rule 2130, if approved as submitted, will be a catastrophe for the CRD, broker regulation, investor protection, and customer arbitration. Securities regulators—the NASD, NASAA, and SEC—will abdicate their responsibilities to the public if they approve the proposed rule.

To understand why the NASD's proposal is so terrible, we will carefully parse the text of the rule. We will also examine the CRD and expungement in their broader contexts, including the legal status of the CRD, why an accurate and unbowdlerized CRD is vital, and why highly limited expungement—if done right—can be a valuable corrective mechanism.

We will also examine important legal ethics concerns. Claimants' lawyers already face serious ethical challenges whenever expungement is raised. Rule 2130 will exacerbate the situation. Lawyers generally worry that they may not be serving their client if they reject expungement in settlement. That is a false reason to expunge. On the contrary, if lawyers agree to improper expungements, they will violate their professional duties and can expose themselves to discipline, court sanctions, and, in the worst case, criminal penalties.

Current Expungement Criteria

At present, under rules that have existed since the CRD began in 1981, NASAA's official position is that expungement is permitted only where the information is "factually impossible" and the expungement is ordered by a court. The SEC acknowledged this restrictive rule, describing factual impossibility in releases in 1999 and 2000:

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[6] SEC, "Protect Your Money: Check Out Brokers and Advisers," http://www.sec.gov/investor/brokers.htm.

[7] Testimony of Arthur Levitt, SEC Chairman, concerning the Large Firm Project, before the Subcommittee on Telecommunications and Finance, U.S. House of Representatives (September 14, 1994), 1994 WL 499982, also on the SEC website at http://www.sec.gov/news/studies/rogue2.txt.

[8] http://pdpi3.nasdr.com/pdpi/REq_Type_Frame.asp.

[9] NASD Notice to Members (NTM) 99-09, effective January 19, 1999, http://www.nasdr.com/pdf-text/9909ntm.txt.

[10] See NTM 99-54, http://www.nasdr.com/pdf-text/9954ntm.txt; NTM 01-65, http://www.nasdr.com/pdf-text/0165ntm.txt; SR-NASD-2002-168, http://www.nasdr.com/pdf-text/rf02_168.pdf, and its preceding news release, http://www.nasdr.com/news/pr2002/release_02_049.html. As of mid January 2003, the SEC had not yet published the rule proposal in the Federal Register or posted it on the SEC website.

> NASD Regulation occasionally receives requests to expunge an event from CRD where the person who was the subject of the CRD filing can demonstrate to the NASD's satisfaction that *it was factually impossible for him to have been involved in the event (e.g., a person was named in an arbitration as a branch manager of a firm, and the person was working at a different firm at that time).* NASD Regulation and the North American Securities Administrators Association ("NASAA") agree that factually incorrect information can be expunged from the CRD if the person obtains a court order of expungement.[11]

Without that level of factual impossibility, expungement is impermissible. Until Rule 2130 or a variant is adopted, Respondents have no basis for asking for exoneration—and claimants are wrong to accede—except in that rare and obviously justifiable circumstance. A colorable claim founded in good faith on facts involving the registered person *cannot* be expunged under the current rules.

Proposed Expungement Rule

Proposed Rule 2130 will turn this situation upside down. It freely permits whitewashing the broker's record whenever the investor's complaint "lacks factual basis" or is dismissed on grounds equivalent to Fed.R.Civ.P. 12(b)(6), or results in a CRD entry that is deemed "defamatory". It also permits expungement in every other circumstance where the NASD decides not to contest the request, and whenever the confirming court disregards the NASD's opposition.

The proposed rule deals solely with customer disputes. Broker-employer disputes are not addressed, since the NASD says they are handled separately. The proposed rule states:

2130. Obtaining an Order of Expungement of Customer Dispute Information from the Central Registration Depository (CRD System)

(a) Members or associated persons seeking to expunge information from the CRD system arising from disputes with public customers must obtain an order from a court of competent jurisdiction directing such expungement or confirming an arbitration award containing expungement relief.
(b) Members or associated persons petitioning a court for expungement relief or seeking judicial confirmation of an arbitration award containing expungement relief must name NASD as an additional party and serve NASD with all appropriate documents.
(1) Upon request, NASD may waive the obligation to name NASD as a party if NASD determines that the expungement relief is based on judicial or arbitral findings that:

> (A) the claim, allegation or information is without factual basis;
> (B) the complaint fails to state a claim upon which relief can be granted or is frivolous; or
> (C) the information contained in the CRD system is defamatory in nature.

(2) If the expungement relief is based on judicial or arbitral findings other than those described above, NASD, in its sole discretion and under extraordinary circumstances, also may waive the obligation to name NASD as a party if it determines that:

> (A) the expungement relief and accompanying findings on which it is based are meritorious; and
> (B) the expungement would have no material adverse effect on investor protection, the integrity of the CRD system, or regulatory requirements.[12]

NASD's Rule Proposal Is A Catastrophe In Waiting

If approved without significant changes, new Rule 2130 will blow the doors off the CRD.

(1) It will turn demanding and negotiating expungements into a free-for-all, leaving only the NASD to seek to block the eventual court order if, in its sole discretion, it chooses to make the attempt.
(2) Expungement demands will appear in virtually every defense and every settlement discussion, vastly increasing the "litigation" component of arbitration and the ethical pressures on claimants' counsel.
(3) It will necessitate dispositive motions to dismiss in every case. Respondents' counsel will probably commit malpractice if they don't make the attempt to get the arbitrators to dismiss investors' claims.
(4) It will make counterclaims that

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[11] Amendments to the Public Disclosure Program, Release No. 34-42402, 71 S.E.C. Docket 1483, 2000 WL 143334, *3 (February 7, 2000) (emphasis added).

[12] SR-NASD-2002-168, http://www.nasdr.com/pdf-text/rf02_168.pdf, pp. 18-19. (Citations to SR-NASD-2002-168 in this article are taken from NASD's proposed text of the SEC's release, pp. 17-31 of the rule filing.)

your complaint "defamed" the broker the general practice rather than the exception.
(5) It will ultimately destroy what's left of the reliability and integrity of the CRD.
The discussion proposals in NTM 01-65 had presented a careful analysis of expungement criteria. They provided certain safeguards for the CRD as a public record, but substantially expanded the circumstances under which a registrant could wipe a nasty from the file. The final proposal is enormously broader than the concepts floated in NTM 01-65.

Amazingly, NASD touts the proposed rule as "*limiting* the removal of customer dispute information" from the CRD.[13] That is clearly untrue when compared to the longstanding current rule. It is untrue even when compared to the concepts proposed in NTM 01-65.

NASD's comments accompanying the proposed rule assert, "NASD and other regulators participating in the CRD system agree that expungement is extraordinary relief."[14] The rule itself completely undermines that principle.

NASAA added its support to the rule filing, apparently not realizing that the final rule is vastly different from the scheme proposed in NTM 01-65 or that litigation realities will cause it to produce tremendously adverse unintended consequences. Christine Bruenn, NASAA president and Maine's securities administrator, is quoted as saying, "This new rule will help protect investors by maintaining the integrity of the CRD system. These new standards will reduce the possibility that a broker would be able to use arbitration and the courts to get a clean CRD record."[15] Unfortunately, reality will likely be the opposite of official expectations.

No Standards

There are so many defects in the proposed Rule 2130 that it's hard to decide which one to discuss first. One of the less obvious problems—but ultimately one of the most important—is the rule structure itself.

Look carefully at how it's organized. *The rule does not prescribe any standards for arbitrators or courts* who are asked to expunge a record. Paragraph (a) requires a court order directing expungement or confirming an arbitration award that granted expungement. Paragraph (b) requires the interested party—the member or associated person—to notify the NASD of a proposed court action. They can ask the NASD to waive its participation in the action. If the NASD does waive, the court action seeking expungement will be uncontested. If the NASD does not waive, they must name the NASD as an additional party.

The only standards in the rule apply solely to the NASD and its decision to participate in the court action. *The criteria do not apply to the parties, or to the arbitrators, or to the courts!* Under the plain language of the rule, they apply only to the NASD. They do nothing more than provide guidelines to the NASD for deciding whether to waive participation. The NASD is supposed to consider four possible criteria, including a catch-all:

(1) There are "findings" that --
(A.) the item is "without factual basis";
(B) "the complaint fails to state a claim upon which relief can be granted or is frivolous";
(C) the information is "defamatory";
(2) or the NASD, in its sole discretion, determines that the findings are "meritorious" and expungement will have "no material adverse effect" on the CRD, regulators, or investor protection.

Nothing in the rule says that arbitrators or settling parties have to limit the award (including stipulated awards) to the criteria that interest the NASD. To the contrary, the catch-all in subpart (2) expressly envisions that the findings may be based on entirely different grounds. Conceivably, the expungement directive can come in an award with no articulated grounds at all.

NASD's commentary accompanying the proposed rule suggests that it

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[13] News Release, http://www.nasdr.com/news/pr2002/release_02_049.html (emphasis added).

[14] SR-NASD-2002-168, p. 23.

[15] News Release. The Securities Arbitration Commentator, usually perspicacious, similarly opined that "the road to actual expungement will be far more uncertain and expensive" and "even deserving brokers seeking expungement will be significantly affected." *NASD Expungement Rule Teed Up With SEC*, SAC Ref. No. 02-40-02, SAC Arbitration Alert 2002-40 (10/9/02). SAC's comments were apparently based on the news release, which preceded the rule filing by 6 weeks and did not give an accurate picture of the rule.

may pursue disciplinary action against members who "seek to expunge any arbitration award that does not contain an expungement order and a finding of at least one of the criteria described in the Notice."[16] That is an empty and unenforceable threat. Because the criteria on their face clearly do not bind members or arbitrators and since the rule expressly allows for expungement in additional undescribed circumstances, NASD would have no basis for such enforcement action.

Of course, while satisfying one or more of the specific criteria is not required, it is highly desirable. Being able to present the NASD with an award containing the right language will mean that the expunger is home free. The NASD will waive the requirement that it be named as a party to the court action, which can then proceed uncontested.

We'll examine the criteria separately. We will also examine whether the NASD can advocate its internal guidelines to a court, revealing some of the serious flaws that make the NASD's promise to protect the CRD look like a paper tiger. First, we look at the likely effects the Rule 2130 will have on investor arbitrations and negotiated settlements.

Expungement Brawl

The proposed rule will turn respondents' expungement demands into no-holds-barred combat. At present, NASAA's strict criteria and NASD's NTM 99-09 impose meaningful constraints on expungement in customer disputes. Any stipulated awards or agreed settlements that do not satisfy the standard of "factual impossibility" are tampering with public records, unethical for claimant's counsel, and a fraud on the court and the public.[17]

Proposed Rule 2130 would throw away that lid. In the absence of explicit and rigorous standards applying to the parties and to the arbitrators, respondents will be free to demand expungement in nearly all circumstances. The NASD's criteria are so broad that they provide no practical disincentive to respondents and virtually no restraint on any party.

Given the importance of a clean CRD record, both for longevity in the securities business and for defending against other customer complaints, claimants should assume that respondents will demand expungement in nearly all cases.

Respondents will surely insert CRD whitewashing into the picture at every opportunity, including settlement discussions and mediation. They will not wait and present their request only at the evidentiary hearing so the arbitrators can render an award. This constant pressure will significantly increase the ethical burdens on investors and their lawyers.

Proposed Rule 2130 virtually invites respondents to coerce customers into agreements to expunge the CRD via stipulated awards. In NTM 01-65, the NASD denounced such behavior as violating "high standards of commercial honor and just and equitable principles of trade" in Rule 2110. Because of NASDR's and NASAA's concerns over the dangers of settlement coercion, NTM 01-65 proposed that only the "clear error" criterion should be permitted in stipulated or agreed awards.[18]

That caution too has been abandoned. The NASD's comment that "NASD is cognizant of the importance of ensuring that the expungement policy does not have an overly broad chilling effect on the settlement process" overtly condones respondents' inclusion of expungement demands in settlement.[19]

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[16] SR-NASD-2002-168, p.30.

[17] See the Legal Ethics section at the end of this article.

[18] Despite the numerous complaints of coercion that led to NTM 99-09, NASD in NTM 01-65 pretended to believe that "it is unlikely that claimant or claimant's counsel would agree that the claim or information at issue was lacking in legal merit or was defamatory in nature." SR-NASD-2002-168, p. 29, reiterating the statement from NTM 01-65. NASDR has ample facts showing that its "belief" is ill-founded.

[19] SR-NASD-2002-168, p. 23. Freeing respondents to obtain expungement through settlement was a major point in the SIA's comment letter on NTM 01-65. http://www.sia.com/2001_comment_letters/pdf/CRDInfo.pdf.

[20] See Scot Bernstein, "Your Clients' Right To A Hearing, 9.1 PIABA B.J. 42 (Spring 2002); C. Thomas Mason III, Challenging Experts In Securities Arbitration, Securities Arbitration 2000 725 (Practicing Law Institute, Corp. Law & Pract. Course Handbook Series #1196, vol. B0-00KP, 2000), at pp. 739-741 (describing what constitutes a "hearing" in Rule 10303).

The proposed rule freely reopens the avenue of coercive misconduct, with little possibility that it can be adequately policed. The NASD's turnabout, whether from hypocrisy or naïveté, is astonishing.

Motions To Dismiss

Proposed Rule 2130 will effectively require respondents to file dispositive dismissal motions in every case. Respondents' counsel will probably commit malpractice if they don't make the attempt to get the arbitrators to dismiss investors' claims.

Criterion (1)(B), "the complaint fails to state a claim upon which relief can be granted", is virtually a verbatim recitation of the standard for dismissing a complaint in Fed.R.Civ.P. 12(b)(6). All a respondent needs for expungement is to win a motion to dismiss on that basis. This creates a host of problems.

First, dispositive motions are totally impermissible unless the claimant waives, in writing, the right to an evidentiary hearing prescribed in NASD Rule 10303(a).[20] Proposed Rule 2130 seeks to dignify and render indispensable an illegitimate practice.

Second, even if the claimant knowingly and deliberately waives her right to an evidentiary hearing, there are no due process protections to ensure that the "motion to dismiss" is decided solely on Rule 12(b)(6) criteria. The standards for 12(b)(6) dismissal in court are well-established: The tribunal must accept the well-pleaded allegations in the complaint as true and draw all reasonable inferences in favor of the plaintiff. Dismissal is proper only where it is clear "beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief."[21]

The purpose of a motion to dismiss is solely to test the sufficiency of the complaint and not to investigate the substance of the claims;[22] "importantly, it does not resolve contests surrounding the facts, the merits of a claim, or the applicability of defenses."[23] Dismissal by motion is a "harsh remedy which must be cautiously studied, not only to effectuate the spirit of the liberal rules of pleading but also to protect the interests of justice."[24]

In arbitration, however, most panelists are not former federal judges. To review a motion to dismiss, the arbitrator must understand (a) the legal standard for review, (b) the necessary elements of each cause of action, (c) how to find those elements in the statement of claim under liberal pleading standards, and (d) the proper procedure of dismissing without prejudice, including permitting the claimant to amend the pleading unless amendment would be futile. Most arbitrators do not have the necessary skills to apply Rule 12(b)(6) standards consistently and accurately.[25]

In fact, many panelists have trouble separating respondents' contentious factual disputations from evaluating the bare sufficiency of the pleading. Respondents' counsel know this and attempt to take full advantage of arbitrators' ignorance and the absence of due process. Respondents' counsel are notoriously sloppy in their motion

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[20] See Scot Bernstein, *Your Clients' Right To A Hearing*, 9.1 PIABA B.J. 42 (Spring 2002); C. Thomas Mason III, *Challenging Experts In Securities Arbitration*, SECURITIES ARBITRATION 2000 725 (Practising Law Institute, Corp. Law & Pract. Course Handbook Series #1196, vol. B0-00KP, 2000), at pp. 739-741 (describing what constitutes a "hearing" in Rule 10303).

[21] *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957).

[22] *Graham v. Sauk Prairie Police Commission*, 915 F.2d 1085, 1100 (7th Cir. 1990); *Republican Party of North Carolina v. Martin*, 980 F.2d 943, 952 (4th Cir. 1992).

[23] *Edwards v. City of Goldsboro*, 178 F.3d 231, 234 (4th Cir. 1999); *see* 5A CHARLES A. WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1356 (1990).

[24] *Morse v. Regents of University of Colorado*, 154 F.3d 1124, 1127 (10th Cir. 1998).

[25] Occasionally, we find a sophisticated exception. See *Birkelbach v. Boston Group*, NASD Docket 99-00813, 2000 WL 1919800,, *3 (Nov. 16, 2000), in which the arbitrators permitted amendment in response to a motion for more definite statement, granted the respondents' motion to dismiss the first amended complaint without prejudice, permitted a second amended complaint, and ultimately dismissed the entire case without prejudice under Rule 10305(a) and referred the parties to their remedies at law. All three arbitrators are experienced lawyers, and two are PIABA members.

practice. They make no serious effort to meet the standards by which a tribunal would review such motions. They "forget" that a motion to dismiss can only question the sufficiency of the pleadings. They do not evaluate the complaint within its four corners, accepting its statements to be true, but persistently demand an evaluation of "evidence" relating to contested facts. They fill their memoranda with disputed facts and contentious defenses which have no place in a motion to dismiss. These "errors" that even a second year law student would not make are so common that they suggest deliberate efforts by respondents' counsel to bamboozle arbitrators who do not have legal training or extensive litigation experience.

Such misconduct could be sanctionable under Rule 11 or 28 U.S.C. § 1927 if presented before an experienced judge. Ironically, panelists' unfamiliarity with legal procedure—which makes respondents' abuse dangerous—also makes it difficult for claimants to get comparable sanctions in arbitration. How do you convince an arbitrator who doesn't realize that he's being hoodwinked to award sanctions against the hoodwinkers?

Third, dispositive motion practice mirroring Rule 12(b)(6) will introduce detailed pleading standards into a forum that promises that pleading will be minimal. The U.S. Supreme Court says that a complaint is sufficient if it provides "'a short and plain statement of the claim' that will give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests."[26] NASD Rule 10314 requires even less: "The Statement of Claim shall specify the relevant facts and the relief sought." Neither a complaint nor a statement of claim has to be self-proving, for "details of both fact and law come later, in other documents,"[27] and in the hearing on the merits.Introducing 12(b)(6) motion practice raises the ugly spectre of elaborate arguments over, for example, the applicable pleading standards for federal securities claims under the Securities Exchange Act and Rule 10b-5. This is a debate on which even the federal circuit courts of appeal cannot agree.[28] Moreover, PSLRA imposes a freeze on all discovery until the motions to dismiss are resolved,[29] forcing panels to render dispositive decisions before the claimant receives any discovery. Legitimizing dismissal motions on 10b-5 pleading standards will not only drag out the proceedings but also put a premium on respondents' stonewalling skills to keep relevant documents out of claimants' hands.

Motions to dismiss replicating Rule 12(b)(6) criteria do not belong in arbitration, and particularly not when the prize for winning is a wiped-clean CRD record. This is especially true while the SROs and the SEC preserve the philosophy that investors can represent themselves and vindicate their claims. The scheme of proposed Rule 2130 will take away several of the advertised benefits of arbitration: a guaranteed evidentiary hearing; minimal motion practice; informal pleading requirements; expeditious resolution; and the ability to proceed without counsel. To borrow PIABA member William Torngren's phrase, it is another stop on the boulevard of broken promises.

"Defamatory" Is Improper

There is no need or justification for a "defamatory" criterion with customer complaints. This is a slop-over from the broker-firm arena, where defamation of individual brokers on the CRD does occur, generally at the hands of former employers and supervisors. The NASD's rule filing gives no more justification than to say that the standard "has been used successfully in the arbitration forum in registered representative/member firm arbitrations, and NASD believes that it is appropriate as proposed."[30]

It is emphatically not appropriate. NASD's rule proposal totally ignores the absolute privilege and immunity that applies in judicial, quasi-judicial,

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[26] *Leatherman v. Tarrant County Narc.Intell & Coord.Unit*, 507 U.S. 163, 168 (1993), quoting Fed.R.Civ.P. Rule 8(a)(2).

[27] *Mid America Title Co. v. Kirk*, 991 F.2d 417, 421 (7th Cir. 1993).

[28] There is a 'widespread disagreement among courts as to the proper interpretation of the PSLRA's heightened pleading requirement.'" *Phillips v. LCI Int'l, Inc.*, 190 F.3d 609, 620 (4th Cir. 1999) (quoting In re Silicon Graphics, Inc. Sec. Litig., 183 F.3d 970, 973 (9th Cir. 1999)). See Brent Wilson, *Pleading Versus Proving Scienter Under the Private Securities Litigation Reform Act of 1995 in the Ninth Circuit* [...], 38 Willamette L. Rev. 321, 324-329 (2002) (reviewing circuit decision).

[29] "In any private action arising under this chapter, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss...." 15 U.S. C § 78u-4(b)(3)(B).

[30] SR-NASD-2002-168, pp. 28-29.

and contractual arbitration proceedings.[31] It will effectively communicate to the arbitrators that such immunity does not apply in arbitration. That is utterly false, but many arbitrators will not know that.

Including a "defamatory" criterion in NASD rules attempts to create a counterclaim which simply does not exist. Allowing purported defamation as an expungement criterion in investor complaints invites—indeed, virtually mandates—respondents' retaliatory counterclaims against the investor for alleged "defamation."

A "defamatory" criterion in Rule 2130 will have other negative consequences. Most importantly, it will seriously chill investors' ability to bring claims against their brokers. For respondents, that may be even more valuable than a clean CRD. Defamation counterclaims are an intimidation tactic that strikes at clients' worst fears: "Do you mean I could lose MORE money?" PIABA members already reported an upsurge in such counterclaims in 2002.[32] Adding "defamation" as an accepted means of wiping the customer's complaint off the CRD is like throwing gasoline on a fire.

Counterclaims for defamation will vastly complicate arbitration proceedings. Claimants will have to educate the arbitrators about absolute immunity and seek to have the counterclaims dismissed.[33] If that fails, claimants will pursue discovery requests seeking, among other things, the unredacted names and addresses of all of the broker's clients, since they will be in the best position to know what his business reputation is. Naturally, that will lead to a discovery fire-fight. If the case eventually gets before the arbitrators, there will be additional hearing dates and concomitant costs. The arbitrators will have to decide which state's law of defamation to apply, a particularly difficult problem when the broker and customer reside in different states and the CRD is a national publication. All of this complexity and expense is totally improper.

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[31] "A party to a private litigation ... is absolutely privileged to publish defamatory matter concerning another in communications ... during the course and as a part of, a judicial proceeding in which he participates, if the matter has some relation to the proceeding." RESTATEMENT OF TORTS 2d, § 587 (1977). "'Judicial proceedings include all proceedings in which an officer or tribunal exercises judicial functions ... an arbitration proceeding may be included."' Bushell v. Caterpillar, Inc. 291 Ill.App.3d 559, 562, 683 N.E.2d 1286, 1288 (Ill.App. 1997) (quoting RESTATEMENT OF TORTS 2d, § 587, comments b and f) (emphasis added by the court). "[P]rivilege for communications made in the context of judicial, quasi-judicial, or legislative proceedings [is] a complete immunity from suit, not a mere defense to liability." *Shanks v. AlliedSignal, Inc.*, 169 F.3d 988, 992 (5th Cir. 1999); see also *Hugel v. Milberg, Weiss, Bershad, Hynes & Lerach, LLP*, 175 F.3d 14, 16 (1st Cir. 1999) ("A statement falls outside the privilege only if it is "so palpably irrelevant to the subject matter of the controversy that no reasonable man can doubt its irrelevancy or impropriety.'").

See M. Schneiderman, Libel and slander: *application of privileges attending statements made in course of judicial proceedings to pretrial deposition and discovery procedures*, 23 A.L.R.3d 1172 (1969); W. E. Shipley, Libel and slander: *privileged nature of communications made in course of grievance or arbitration procedure provided for by collective bargaining agreement*, 60 A.L.R.3d 1041 (1974). (John B. Lewis & Lois J. Cole, *Defamation Actions Arising From Arbitration And Related Dispute Resolution Procedures-Preemption, Collateral Estoppel and Privilege: Why The Absolute Privilege Should Be Expanded*, 45 DePaul L. Rev. 677 (1996), observe that the rule is not absolute in labor arbitrations under a collective bargaining agreement). See also Sheri L. Marvin, *Libel and Slander: Deposition testimony and other statements taken in connection with private, contractual proceedings are protected from tort liability by the absolute immunity granted under California's litigation privilege*, 22 Pepp. L. rev. 1322 91995).

"This absolute privilege shields speakers from liability even if their motives were malicious, or they knew the statement was false, or their conduct was otherwise unreasonable." *Imperial v. Drapeau*, 351 Md. 38, 44, 716 A.2d 244, 247 (Md.App. 1998); see *Odyniec v. Schneider*, 322 Md. 520, 588 A.2d 786 (Md. 1991) (expert witness' allegedly defamatory statements made in connection with arbitration are absolutely privileged, just as they would be in court, even when the remarks may have been gratuitous, unsolicited, and said outside the actual hearing); *Sturdivant v. Seaboard Service System, Ltd.*, 459 A.2d 1058 (D.C. 1983) (absolute immunity to complaining witness' statement).

[32] Correspondence on file with the author.

[33] Ironically, this will reverse the usual roles of customers and respondents regarding dismissal under Rule 10303. Claimants will have to argue that pre-hearing dismissal is legitimate, and respondents may find themselves contending that Rule 10303 gives them an absolute right to an evidentiary hearing on their claims.

Defense lawyers advocating expungement state that "traditional defamation principles apply in arbitration just as they do in the rest of society."[34] They evidently forget that in the rest of society, allegations in court pleadings get absolute privilege and immunity from suit. Furthermore, civil lawsuits are part of the permanent public record and are not expungeable.

Members of the securities industry are not entitled to greater protection from complaint or suit than other members of society. Nor do they have any greater right to retaliate for alleged "defamation" in the pleadings. Like other members of society, they have no right to claim that a customer's complaint "defamed" them.

Catch-Alls

The criterion of "without factual basis" is too vague. It is dangerous, both to those trying to maintain an accurate CRD and to brokers trying to correct legitimate errors.

The NASD says that it includes the "factually impossible" and "clear error" standards that presently exist, but offers no further explanation.[35] Yet the phrase "without factual basis" is clearly much broader than the examples previously quoted for factual impossibility.

In arbitrators' minds, "without factual basis" could mean nothing more than the claimant failed to meet her burden of proof. Unless the arbitrators give more than just a one-sentence finding, neither the NASD nor state securities regulators will ever know otherwise. That is obviously not an adequate basis for expunging an investor complaint from the permanent record.

The NASD's own catch-all is even broader. The NASD permits itself to determine—in its sole discretion—that the findings supporting the expungement order are "meritorious". How will it know? Whom will it ask? What constitutes "meritorious"? This provision is nothing but a blank check to the NASD to expunge whatever it wishes.

Together with a blank check, the proposed rule has no accountability. There is no requirement for the NASD to maintain records of what action they take, so regulators and the public will never know what they did, who did it, why they did it, how many expungements were permitted to proceed unopposed, how those determinations were made and by whom, how many requests were opposed and on what grounds, and so on.

NASD Enforcement Uncertain

The meat of proposed Rule 2130 is in the NASD's participation in court proceedings, ostensibly to oppose improper expungements. The rule requires naming the NASD as an additional party in such confirmation and expungement proceedings. However, the rule proposal itself provides no assurances that NASD will actively oppose objectionable attempts to expunge, or that NASD's opposition will be effective. The entire enforcement side of proposed Rule 2130 is highly doubtful.

NASD's comments accompanying the rule filing assert, "The proposed rule will state that NASD will participate in such judicial proceedings and will oppose expunging dispute information in such judicial proceedings" unless the tribunal made specific findings satisfying the NASD's criteria.[36] In fact, the proposed rule says no such thing.[37] There is nothing in proposed Rule 2130 declaring or requiring that the NASD "will oppose" anything.

Former state securities administrators who have dealt with the NASD on CRD issues question the NASD's commitment to permitting expungement only in compelling and exceptional circumstances. One former state commissioner wrote privately,

> [I] had to deal with the NASD on CRD matters from the day that CRD was proposed. No good can come from the NASD, on its own, being allowed to decide what is on the system and what is not. ...

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[34] Mark J. Astarita, *Rogue Customers*, http://www.seclaw.com/docs/1097.htm (Oct. 1997). The statement by itself is true—but only when it means the opposite of what Mr. Astarita intended.

[35] SR-NASD-2002-168, p. 28.

[36] SR-NASD-2002-168, p. 20.

[37] The reader wonders if NASD changed the text of the proposed rule after the comments were drafted – and after NASAA gave its *nihil obstat* to those concepts.

Trust me, the NASD will never fight to keep something in the records of CRD.[38]

Another former state commissioner and NASAA official, who has been intimately involved in the expungement controversy, is less pessimistic: "I honestly believe that the NASD will fight expungement in all but the most obvious cases. There is no way they will accept expungement if money changes hands."[39]

Not Binding On Courts

Even if we assume the most optimistic view, there is no assurance that the NASD's opposition will have one whit of impact on the courts. Simply put, the criteria in proposed Rule 2130(b) may be binding on the NASD, but they are not binding on federal or state judges.

The NASD's purported protections are predicated on its discretion to appear in court to oppose the expungement. (Let us suspend skepticism and assume for the moment that the NASD would rigorously oppose expungement proceedings that did not meet the highest standards of scrutiny.) But the success of its opposition may be highly doubtful.

What grounds would the NASD use to convince a court not to confirm the expungement order in an arbitration award?

If it asks the court to vacate the award under normal procedures of the Federal Arbitration Act, it will fail. The NASD's opposition cannot be based on any of the statutory criteria for vacatur in 9 U.S.C. § 10(a), on the criteria for modifying an award in 9 U.S.C. § 11, or on manifest disregard of the law. Proposed Rule 2130 is not a law, just a rule of the SRO. Since the rule is in the 2000 series, it is not a rule of arbitration, it is not binding on the arbitrators, and it does not limit their powers. Arbitrators are free to issue expungement orders on any grounds they choose. Further, proposed Rule 2130 does not prescribe criteria to the court for determining whether expungement is permissible. As we have seen, it only defines the circumstances under which the NASD may waive participation in the court proceeding. Unless the NASD can show that the award was obtained by fraud, corruption, or misconduct of the arbitrators, there is no reasonable hope of blocking confirmation of the expungement.

Another theory suggests that the NASD could oppose the expungement in its capacity as administrator of the CRD responsible for protecting the public record.[40] I have found some small support for this in labor cases, one by the National Labor Relations Board, another by the Connecticut State Board of Mediation and Arbitration.[41] But again, the three criteria in 2130(b)(1) govern the NASD's choice to intervene, not the court's evaluation in confirming or denying the award. While the court might give some deference to the NASD's views,[42] there is no assurance that the court would adopt the NASD's criteria for its own decision.

Factual Basis From Where?

Furthermore, unless the arbitrators give written explanations, how is anyone—including the NASD—going to know what criteria were applied?

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[38] Private communication, Jan. 6, 2003 (on file with the author). This commissioner was horrified to discover NASD's sloppy controls over CRD information. For example, "13 people had authority to enter fingerprint information directly into the CRD without a tracking mechanism even though only 2 people actually handled the fingerprint cards – it would have been worth a $1000 bucks for a felon to have one of these people enter that they had a clean rap sheet and no one would have known."

[39] Private communication, Jan. 6, 2003 (on file with the author).

[40] I thank Scot Bernstein for this suggestion. The NASD itself is silent on the entire question.

[41] See *International Longshoremen's and Warehousemen's Union, Local 32 v. Pacific Maritime Ass'n*, 773 F.2d 1012, 1020 (9th Cir. 1985) (NLRB may intervene to oppose an award that, if enforced, would undermine a section 10(k) NLRB work assignment); *City of Milford v. Local 1566, Council 4, AFSCME*, 200 Conn. 91, 510 A.2d 177 (Conn. 1986) (although State Board did not have interest in whether award was ultimately vacated or confirmed, it had significant interest in protecting validity of procedures used to determine award).

[42] *Littman v. Morgan Stanley Dean Witter*, 337 N.J.Super. 134, 143, 766 A.2d 794, 799 (N.J.Super. 2001) (NASD's rule filing commentary is entitled to deference); *First Heritage Corp. v. NASD*, 785 F.Supp. 1250, 1251 (E.D.Mich. 1992) (same). We should note that in other cases, courts have routinely disregarded the commentary in SEC

Since the arbitrators can't be deposed, what will the NASD do? Factual basis is also troublesome in stipulated awards, since the arbitrators may not have made an independent decision.

Will the NASD go to the parties' counsel and get affidavits? The rule filing suggests this possibility: "In connection with making the required arbitral findings in such cases, NASD will explore the use of telephonic versus in-person hearings, as well as the option of making a decision based on briefs and affidavits from the parties and relevant third parties."[43]

Will you as claimants' counsel swear under oath that the claim that you agreed to expunge, which you submitted in good faith and which you know in your heart to be meritorious (after all, they just paid you to settle it!) – will you swear that it was frivolous, or without factual basis, or failed to state a claim on which relief could be granted?? If so, you're in deeper trouble than the broker.

Any claimant's counsel who grants such an affidavit—or permits respondents' counsel to make such representations on her behalf—will commit a fraud on the court,[44] violate the professional responsibility rule requiring candor toward the tribunal,[45] and participate in a conspiracy to falsify or tamper with public records. Perjury carries civil and criminal penalties. So does tampering with public records.

No lawyer who values his or her liberty, property, ethical obligations, and license to practice law can participate in such a scheme and provide the NASD the "factual basis" that it seeks.[46]

Missed Opportunity

The enforcement situation would be very different if the expungement criteria were binding on members and arbitrators. For example, the proposed rule could have a counterpart or cross-reference in the NASD Code of Arbitration Procedure, limiting arbitrators' power to grant expungement except in specifically delimited circumstances and requiring reasoned findings substantiating such a recommendation. If arbitrators issued an award (including a stipulated award) that did not satisfy the requirements, the arbitrators would exceed their powers or render an imperfect award. The proposed expungement would be vacatable under 9 U.S.C. § 10(a)(4)[47] or modifiable under § 11(c). The NASD's criteria would be directly imported into the judicial proceeding and would govern the court's decision.

The fact that the NASD did not write the rule in this manner causes us to question its commitment to opposing nonconforming expungements. Undoubtedly the NASD and NASAA folks who originally developed this proposal had a rational idea of how it would function. However, the way proposed Rule 2130 finally turned out, the NASD's purported protection of the CRD is mostly chimerical. Gertrude Stein would recognize the situation immediately – there's no There there.

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rulemaking. They did this repeatedly in Rule 10304 / Sec. 15 eligibility rule decisions contravening the 1984 rule amendment that expressly intended to "make the Code's time limitation co-extensive with various state statutes of limitations and permit all securities-related disputes which are eligible for a judicial disposition to be resolved by arbitration." SEC File No. SR-NASD-84-16, Release No. 34-21188, 31 SEC Docket 31 (Aug. 2, 1984). See C. Thomas Mason III, *Irreducible Disagreements: The Six-Year Rule Revisited*, 1 SECURITIES ARBITRATION 1997 557 (Practising Law Institute, Corp. Law & Pract. Course Handbook Series #998, vol. B4-7195, 1997), at p. 578; contrast *Bayley v. Fox*, 671 N.E.2d 133 (Ind.App. 1996), discussed at pp. 695-696, which supported its decision with the SEC's release but without giving it deference.

[43] SR-NASD-2002-168, p. 29.

[44] See, among many, *Hongsermeier v. C.I.R.*, --- F.3d ----, 2003 WL 132992 (9th Cir., Jan. 17, 2003) (conduct designed to prevent the court and public from learning of settlement agreements was a fraud on the court, and no showing of prejudice is required).

[45] See ABA Model Rule 3.3; C. Thomas Mason III, *Lawyers' Duties of Candor Toward the Arbitral Tribunal*, 1 SECURITIES ARBITRATION 1997 59 (Practising Law Institute, Corp. Law & Pract. Course Handbook Series #998, vol. B4-7195, 1997).

[46] See the Legal Ethics section at the end of this article.

Accurate CRD Is Vital

The ability to correct inaccurate or defamatory entries is very important. The CRD is—or should be—vital to the career of a broker. Regulators' "Rogue Broker" projects condemned the practice of hiring peripatetic bad brokers and retaining them despite numerous customer complaints.[48] A massive overhaul of the CRD recommended by the "Large Firm Project" made it a more effective tool for firms trying to avoid problem brokers, for regulators in their investigations, and for public customers seeking information about their advisors. The NASD summarized the importance of the CRD in NTM 01-65:

Regulators use the registration information, and other information contained in the CRD system, to assist them in fulfilling their regulatory responsibilities, including making determinations about registration and licensing of firms and associated persons. Member firms use the CRD system to help them meet their registration, licensing, and certain other compliance obligations. Much of the information reported to the CRD system is made publicly available, either by NASD Regulation through its Public Disclosure Program (PDP) or by the SEC and individual state securities administrators pursuant to applicable law.

Negative information on the CRD can end brokers' careers and deprive them of their livelihood. "Ever try to switch brokerages with such a record? You are radioactive," writes a defense lawyer.[49]

Less measurably, CRD dings can adversely affect or can diminish a broker's ability to attract and retain conscientious clients. As investors become more aware of the online public disclosure information, flawed though it is, and the more complete paper record from state securities administrators, they can proactively screen potential advisor relationships and not do business with brokers whose records concern them. A broker may never know what good clients chose not to do business with him or her because of information on the CRD, but the effects are there.

It is therefore essential that CRD records be accurate, complete, and comprehensible. This is particularly significant because the CRD combines the worst features of self-reporting and adversary reporting with few of the cross-checks and protections that ordinary public records have.

CRD Is A Public Record

The CRD is a public record, literally and legally. Yet it differs from other "normal" public records in some significant ways. A broker's CRD record is very public. Most portions are available online,[50] or by picking up the telephone and calling either the NASD Public Disclosure Program or—better—the state securities division.[51] In this way, the CRD is more public than most public records, which have been slower to convert to online access.

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[47] One court questioned, without deciding, whether an award can be partially vacated using the standards of § 10. *Legion Ins. Co. v. VCW, Inc.,* 198 F.3d 718, 721 n. 5 (8th Cir. 1999). However, the issue appears more theoretical than real, since courts routinely do exactly that. See, e.g., *Lummus Global Amazonas S.A. v. Aguaytia Energy del Peru S.R. LTDA*., --- F.Supp.2d ----, 2002 WL 31401996 (S.D.Tex. 2002) (rejecting the restriction); *Davis v. City and County of San Francisco*, 984 F.2d 345 (9th Cir. 1993) (vacating just the award of expert fees); *United Food & Commercial Workers v. National Tea Co*., 899 F.2d 386 (5th Cir. 1990) (vacating injunctive portion of award); *Landy Michaels Realty Corp. v. Local 32B-32J, Service Employees Intern. Union, AFL-CIO*, 954 F.2d 794 (2nd Cir. 1992) (vacating damages portion of arbitration award).

[48] See "Joint Regulatory Sales Practice Sweep: A Review of the Sales Practice Activities of Selected Registered Representatives and the Hiring, Retention, and Supervisory Practices of the Brokerage Firms Employing Them" (March 1996). The Sweep combined the resources of the SEC, NASD, NYSE, and NASAA to review problem brokers and the hiring, retention, and supervisory practices of firms employing them. The report is available at http://www.sec.gov/news/studies/sweeptoc.htm. The Sweep followed "The Large Firm Project: A Review of Hiring, Retention and Supervisory Practices" by the SEC's Division of Market Regulation and Division of Enforcement (May 1994), http://www.sec.gov/news/studies/rogue.txt.

[49] Bill Singer, *Street Legal: Charged, Therefore Guilty*, REGISTERED REP. (Feb. 1, 2002), http://registeredrep.com/ar/finance_street_legal_charged/index.htm.

[50] In 2002 the NASD decided to limit public online access through the internet to specified hours during the day and early evening: "The web site is available from 7.00 a.m. to 11 p.m. ET Monday through Friday and 8.00 a.m. to 8.00 p.m. ET Saturday and Sunday." http://pdpi.nasdr.com/pdpi/ (after hours). For totally unexplained reasons, NASD shuts off access during the hours when working investors with children finally have free time to get onto their computers. This particularly affects investors in western and Pacific states, since the system closes down at 8 PM

More importantly, the CRD is legally a public record. NTM 99-54 acknowledged NASAA's longstanding insistence on this point:

> NASAA has informed NASD Regulation that, in its opinion, according to various state laws, information submitted to the CRD system is deemed to have been filed with each state in which the subject person or entity seeks to be registered. Therefore, according to NASAA, information in the CRD system that may be the subject of an arbitrator-ordered expungement is in many cases a state record, and some state laws currently do not recognize the authority of an arbitrator to expunge a state record or do not otherwise permit such expungements because of state recordkeeping requirements.

In 1999, the SIA pooh-poohed that concept.[52] In a letter responding to NTM 99-54 and advocating a return to the free-and-easy days of arbitrator-ordered expungements, the SIA claimed that the only support for "state record" status came from an opinion of the Florida Attorney General. The SIA did not do its homework before attempting to refute Florida's position. Its argument about state law is simply wrong.

The Florida Attorney General concluded that CRD records are state records and cannot be expunged except in conformity with Florida law. The opinion further stated, "An agency may not avoid its responsibility under the Public Records Act by transferring custody of a record to another entity."[53]

California statutes unambiguously designate CRD records as a "public record" which is available for public inspection. See Cal.Corp.Code § 25247 and Cal.Gov.Code § 6254.12. The latter reads:

> Any information reported to the North American Securities Administrators Association/National Association of Securities Dealers' Central Registration Depository and compiled as disciplinary records which are made available to the Department of Corporations through a computer system, shall constitute a public record.

You can't get much clearer than that. And there are numerous other examples. The Oklahoma securities commissioner may designate filing depositories—including the CRD—for records required to be filed and maintained under the Oklahoma Securities Act.[54] At the time of the SIA's letter, Arkansas treated securities agents' filings under the Arkansas State Records Management and Archives Act and permitted the state commissioner to participate in the CRD for maintaining and retaining such public records.[55] Many other states authorize their securities commissioner to participate in the CRD for the purpose of centralizing and streamlining record-keeping, filing, and retention.

I have not found a state that has abandoned its own regulation of

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Pacific time on weekdays and 5 PM on weekends. For investors overseas, the problem is even worse. NASD's computers don't sleep; they certainly don't sleep 8-12 hours a night. There is no rational explanation for this denial of service, except to make it difficult for some members of the public to obtain valuable information.

[51] The NASD's PDP summaries often have significantly less information than printouts from state securities administrators. Seasoned practitioners refer to the online report as "CRD-Lite" and, whenever appropriate, get the full report from their state securities division. A full critique of the online disclosure system is beyond the scope of this article.

[52] http://www.sia.com/1999_comment_letters/html/nasd99-7.html (July 30, 1999).

[53] Advisory Legal Opinion by Robert A. Butterworth, Attorney General of the State of Florida, AGO 98-54 (August 28, 1998), http://legal1.firn.edu/ago.nsf/aaee37715760bbce852563cc001bacf7/d3d4288d6bfa789085256671004cada9!OpenDocument

[54] 71 Okl.St. § 411.

[55] Ark.Code § 23-42-206. The entire State Records Management and Archives Act was repealed in 2001 for reasons that have nothing to do with the CRD. Acts 2001, No. 1252, § 1.

brokers and agents in favor of whatever the NASD unilaterally decides to keep in the CRD. Mr. Mark Sendrow, Director of the Arizona Securities Division and a member of the NASAA board, puts the matter in perspective: When the states and the NASD got together some twenty years ago to create the CRD, no state gave up its records simply by having asked the NASD to coordinate the national system.[56]

It's illegal to tamper with or falsify a public record.

Self-Reporting Problems

The CRD is essentially a self-reporting system. Associated persons are required to update their own U-4.[57] Sometimes this is done by the registered representative himself, usually in conjunction with the firm's legal or compliance department. There is a structural incentive to disclose as little as possible and to spin it in the broker's favor. The results, as anyone who has received public disclosure information from the NASD has already noticed, are typically meaningless, self-exculpatory denials and blah-blah that are useless for investors. Self-reported entries on the CRD generally cannot be considered to be true and accurate disclosure of the investors' complaints.

In some ways, the CRD would be far more useful for investors if the complaining party were permitted to submit a summary of the complaint. This would at least counterbalance the one-sided self-interested reports that the CRD currently contains. However, it would open up brokers to genuine defamation by their unhappy customers. While NASDR could provide protections by having the Enforcement Division check the investor's proposed CRD entry to ensure that it accurately reflects the allegations in the complaint that the investor intends to prove, that could prove more troublesome than the current system.

Broker-dealers also have an incentive to obfuscate and exculpate on CRD entries regarding their brokers. They won't say anything that may concede wrongdoing by this registered representative or that may reveal a pattern of flawed supervision by the firm. In addition, when the broker is still a valued producer, the firm won't want to say anything that could cause the broker's clients or prospective customers to turn away.

Ex-Employers Can Become Adversaries

On the other hand, firms can become brokers' adversaries. Once a registered representative has left the firm, she becomes vulnerable to vicious, retaliatory, and ultimately defamatory entries on her CRD record. We see this particularly after the broker and firm have been hit with complaints or arbitration awards to investors. The U-5 filing is an opportunity for the firm—especially the branch office manager—to blame the departed representative for the supervisor's or firm's failings, or simply to vent personal conflicts between the representative and her superiors. Such instances are particularly pernicious when the personal conflict was sexual harassment or other civil rights violations by the superior.

When firms file ugly U-5s sliming the representative's record, prospective employers reading those reports can and do refuse to hire the representative. Negative reports can drive the representative out of the securities industry, costing her career and her livelihood.

These dangers, more than any other, motivate thoughtful advocacy of finding means to expunge inaccurate or defamatory information. The National Association of Investment Professionals (NAIP)[58] has been at the forefront of this effort. Predictably, brokerage firms have a different idea of U-5 disputes. In their view of the world, "Disgruntled former employees not infrequently threaten groundless defamation actions based on these filings."[59]

In my experience, mean-spirited CRD filings by former employers do occur. For example, in the early 1990's, Prudential Securities was in the dock for its massive multi-billion dollar systemic corporate fraud in the

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[56] Personal communication, Jan. 15, 2003.

[57] "We wish to reiterate that the responsibility for maintaining the accuracy of the Form U-4, by updating the information in the filing, as necessary, lies with the registered representative." *Frank R. Rubba*, Release No. 34-40238, 67 S.E.C. Docket 1305 (July 21, 1998).

[58] See http://www.naip.com/ (not to be confused with http://www.naip.org/, the National Association for Indexed Products). (The website is not kept up to date very well.)

[59] Daniel L. Goelzer, Baker & McKenzie, Statement of the Securities Industry Association concerning the Securities Litigation Reform Act before the Telecommunications and Finance Subcommittee of the House Committee on Commerce, February 10, 1995, 1995 WL 57110, at n. 34 (advocating legislation to grant firms absolute immunity for their statements on former employees' U-5s).

creation and marketing of limited partnerships. The company lied to its employees about the safety and profitability of its limited partnerships; loyal and otherwise conscientious employees believed their company and unwittingly passed on the lies to their valued clients. The limited partnerships went down the tubes, taking investors' money with them and causing a national scandal. Investors sued, regulators investigated, and Prudential paid nearly $2 billion in awards, judgments, regulatory fines, and legal fees.

In numerous cases, investors deliberately did not name their financial consultant as a respondent, recognizing that the rep was also victim of Prudential's lies. They wanted simply to recover their money and did not want to harm their financial consultant. Where the broker had left Prudential Securities by the time the case was resolved, Prudential often reported the outcome on an amended U-5, even though allegations of wrongdoing were against the company itself and there were no allegations of sales practice violations by the rep. This practice was particularly offensive where the U-5 amendment resulted from an award through the SEC's expedited arbitration process, which recognized the corporate wrongdoing. Prudential had no reason to besmirch the CRD of its former employees, other than out of spite or retaliation for their having moved to more reputable firms and taken the tattered remnants of their client book, or to perpetuate Prudential's corporate fiction—which it maintained in spite of facts and evidence and regulatory findings—that the limited partnership debacle was simply the fault of irresponsible representatives.[60]

A second example comes from Prudential Insurance and its broker-dealer subsidiary Pruco Securities, and the product failure of its "vanishing premium" life insurance arising from systematic company-wide deceptive marketing.[61] Once again, when clients complained, the company sought to blame the individual representative/agents, even when clients clearly stated that they had no complaints about the agent. In cases I worked on, the pattern was clear: if the agent was still with Pruco, there was no amended U-4 unless there was an unavoidable complaint that the agent's conduct exceeded the company's own mispractice. But after the agent left Pruco, there was no restraint. Managers filed amended U-5s retroactively to tarnish the agent with earlier complaints which, if they were reportable at all, should have been filed on the rep's U-4 many months earlier. A number of former representatives brought claims for defamation. They were often successful both in collecting money and in obtaining nonmonetary relief that can be even more valuable—they got the offending entries in their CRD record amended or expunged.[62]

The third example, involving cases of sexual harassment or other civil rights violations, is perhaps the ugliest. When the representative leaves the company, the branch office manager submits a U-5 with trumped-up reports of poor work habits, inability to deal with clients, failure to follow supervisor's instructions, etc. Violations of personal dignity are followed by actions that threaten her livelihood. Such statements on a U-5 are even more potent in jeopardizing an individual's career than customer complaints because of their content. The representative's only long-term remedy is to get the false report expunged from the CRD.

But Employer Defamation Is Already Covered

These abuses legitimately support appropriate mechanisms for expungement. However, it is important for us to recognize that they are totally unaffected by proposed Rule 2130. All of these

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[60] Prudential denies all this, of course, but the defamation claims against the company speak for themselves.

[61] See *In re Prudential Insurance Company America Sales Practice Litigation*, 148 F.3d 283 (3rd Cir. 1998) and related decisions.

[62] Prudential was certainly not the only firm to engage in such practices. *Dawson v. New York Life Ins. Co.*, 135 F.3d 1158, 1163-4 (7th Cir. 1998), responded to concerns that giving securities firms absolute privilege for remarks on the U-5 "will invite vindictive brokerage firms to embellish customer complaints so as to harm the reputations of agents who have fallen into disfavor." The court rejected the employer's plea for absolute immunity and stated that "while even meritless complaints against agents must be reported on Forms U-5, individual agents can rest assured that securities firms do not have free rein to report customer complaints in any way they like, exaggerating complaints or inventing them wholesale with absolute immunity to do so."

problems, the primary impetus of the NAIP, are employee-firm disputes. By its own terms, proposed Rule 2130 expressly deals only with customer complaints and offers no solace or protection against wrongful actions by firms toward their own former employees. The NASD's rule filing acknowledges this discrepancy. Under already existing policy, the NASD will honor—without a court order—expungement directives arising from employee-firm disputes "in which the arbitration panel states that expungement relief is being granted because of the defamatory nature of the information."[63]

Since correcting the greatest source of inaccurate or defamatory information is already in place and is not affected by the proposed rule, we have to question what genuine wrongs the proposed rule intends to address. None is apparent.

"Rogue Customers" and Frivolous Complaints

Some defense counsel complain of "rogue customers" whose irresponsible filings unjustly besmirch brokers' records.[64] Of course, the number of times respondents' counsel cry that the claim is frivolous is several orders of magnitude larger than the number of cases in which the arbitrators agreed that was true. The databases are replete with awards reciting respondents' boilerplate in which the arbitrators found wrongdoing and entered awards against the respondent.

However, some investors have filed truly frivolous and harassing claims against brokers. Not only do arbitrators flatly reject such claims, some of the awards even assessed forum fees and/or attorney fees against the complainant as penalty for bringing a frivolous case.[65] The awards are public, and the brokers certainly reported the successful outcome to the CRD, so there is no need for expungement.

Besides forum fees, attorney fees, and sanctions in the arbitration, the appropriate remedy for demonstrably frivolous and harassing claims is an action for malicious prosecution. Its functions are:

> to recompense a defendant sued in a malicious and baseless legal action for: (1) his attorney fees; (2) his costs; (3) his psychic damage from the shock of the unfounded allegations in the pleadings; and (4) the loss of his reputation in the community as a result of the filing and notoriety of the base allegations in the pleadings which are public records.[66]

The basic elements of tortious wrongful prosecution are generally: "(1) favorable termination of the prior proceeding, (2) lack of probable cause to support the original action,

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[63] SR-NASD-2002-168, p. 22 n. 4

[64] See Mark J. Astaria, *NASD Expungement Order Proposal Release*, http://www.seclaw.com/docs/expungement1201.htm *(Dec. 17,* 2001) (criticizing NTM 01-65)*,* and his earlier editorial, *Rogue Customers*, http://www.seclaw.com/docs/1097.htm (Oct. 1997*),* in which he complained of customers "who send complaint letters, file regulatory complaints, commence arbitrations and start federal lawsuits, accusing their brokers of a wide variety of fraudulent activity, when the customer himself knows that the complaint is without merit." It might be noted that in the 1990s, Mr. Astarita's law firms represented some of the most unsavory members of the securities community.

[65] For example*:* "In awarding attorney's fees, the panel considered the claim brought against Respondent to be frivolous in nature." *Texvest Factors & Financial Svcs Corp. V. Shearson Lehman Brothers,Inc.*, NASD Docket 91-02519, 1993 WL 147553, *2 (Feb. 12, 1993). "Claimant is liable to and shall pay to Respondent Mercer $15,000.00 for attorney's fees and legal expenses incurred as a result of the frivolous and defamatory nature of the claim." *Redwing Robin L.P. v. Southern Financial Group, Inc.*, NASD Docket 99-02504, 2000 WL 1278039, *4 (June 12, 2000) (also ordering expungement, conditioned on confirmation from a court of competent jurisdiction). The Securities Arbitration Commentator, Inc. Has an entire package of awards in which the arbitrators have awarded sanctions of various kinds. P.O. Box 112, Maplewood, NJ 07040; 93 Riggs Place, So. Orange, NJ 07079-973-761-5880, fax 973-761-1504.

[66] *Walford v. Blinder, Robinson & Co., Inc.* 793 P.2d 620, 623 (Colo.App. 1990) (quoting *Stanley v. Superior Court*, 130 Cal.App.3d 460, 181 Cal.Rptr. 878 (Cal.App. 1982)), cert. Dismissed sub norm. *Keller v. Walford*, 498 U.S. 977 (1990). (PIABA member Steve A. Miller of Denver represented the Walford plaintiffs.)

and (3) malice in bringing that action."[67] In most jurisdictions, an arbitration award terminated in favor of the broker will support such an action, even though arbitrators are not required to make detailed findings and the hearing records maybe incomplete.[68] "[A] malicious prosecution action involves not a review of the reasons for the decision in the prior action, but rather an analysis of the circumstances that led the [complainant] to pursue that action."[69]

Those well-recognized remedies—especially compensation for unfounded allegations and loss of reputation (items (3) and (4) above)—are the legitimate relief that aggrieved brokers are seeking through the jerry-rigged alternative of expungement. Such private relief can be obtained without the disadvantages of tampering with public records designed for investor protection.

De Facto Expungements

The securities industry already exercises its own de facto whitewashing of the permanent record simply by not reporting adverse events to the CRD. Distressingly many members—including biggest top-tier firms—continue to fail to comply with basic reporting requirements of CRD registration forms and NASD Rule 3070. NASD's occasional enforcement has been lackluster at best. The virtual absence of systematic enforcement is all the more incomprehensible since the NASD already gets full information regarding investors' arbitration complaints, as well as notices that cases have settled.

Historically, the right hand did not communicate with the left hand. Dispute Resolution did not communicate investor complaints or trends to Enforcement.[70] Both the NASD and the NYSE have been amazingly lax in coordinating information they already received—statements of claim vs. U-4/U-5 filings; notices of settlement vs. U-4/U-5/BD—and instituting appropriate regulatory actions.

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[67] *Andrus v. Estrada*, 39 Cal.App.4th 1030, 1039, 46 Cal.Rptr.2d 300, 305 (Cal.App. 1995); see also RESTATEMENT OF TORTS 2d, § 674. The *Andrus* decision gives a fascinating history of wrongful civil prosecution, showing that the cause of action has existed in the common law since before 1269.

Some American courts prefer to call the tort action arising from civil disputes "abuse of process" or "wrongful use of civil proceedings", leaving "malicious prosecution" to complaints arising from criminal matters. In some of those states, the difference is more than just nomenclature. "Under New York law, an abuse of process claim 'has three essential elements: (1) regularly issued process, (2) an intent to do harm without excuse or justification, and (3) use of the process in a perverted manner to obtain a collateral objective.'" P*SI Metals, Inc. v. Firemen's Ins. Co.*, 839 F.2d 42, 43 (2nd Cir. 1988) (*quoting Curiano v. Suozzi*, 63 N.Y.2d 113, 116, 469 N.E.2d 1324, 1326 (1984). The NY Court of Appeals also wrote that "the institution of a civil action by summons and complaint is not legally considered process capable of being abused." *Id*. This is an emphatic substantiation that claimants are immune from defamation for allegations made in the course of an arbitration claim.

[68] E.g., *Walford v. Blinder, Robinson & Co., Inc.*, 793 P.2d at 623; *Neely v. First State Bank, Harrah, Okla.*, 975 P.2d 435 (Okla. 1998); *Taylor v. Peoples Gas Light & Coke Co.*, 275 Ill.App.3d 655, 656 N.E.2d 134 (Ill.App. 1995); *Eurotech, Inc. v. Cosmos European Travels A.g.*, 189 F.Supp.2d 385 (E.D.Va. 2002); *Luppo v. Waldbaum*, 515 N.Y.S.2d 871 (N.Y.App.Div. 1987); *see also Pujol v. Shearson/American Express, Inc.,* 877 F.2d 132 (1st Cir. 1989); *International Medical Group, Inc. v. American Arbitration Ass'n, Inc.*, 312 F.3d 833, 845 (7th Cir. 2002).

However, the remedy is not available in California: "Whether the underlying action started in court or in arbitration, if it ends in contractual arbitration, that termination will not support a malicious prosecution action." *Brennan v. Tremco Inc.*, 25 Cal.4th 310, 314, 20 P.3d 1086, 1088, 105 Cal.Rptr.2d 790, 792 (Cal. 2001). To the extent that this disadvantages brokers in California, it is a self-inflicted problem that the securities industry has created by insisting that even its own employees give up their legal rights and submit all disputes to arbitration. It does not justify expungement.

[69] *Walford v. Blinder, Robinson & Co., Inc.*, 793 P.2d at 623.

[70] This was evident in the Prudential Securities limited partnership scandals, where the NASD had the earliest and best knowledge of the breadth and depth of the problem, yet did nothing with it. The massive enforcement case was later developed by state securities administrators, which Johnny-come-lately NASD joined at the tail end. See KURT EICHENWALD, SERPENT ON THE ROCK (HarperBusiness, 1995).

At the NASD's Fall Securities Conference, October 2002, Mary Shapiro, President of NASDR, Inc., informed me that those days are over at the NASD. Just as law enforcement and intelligence agencies discovered after September 11, 2001 that they didn't use information they already had and are now seeking better coordination, the NASD is developing information-sharing infrastructure to assemble data more meaningfully and ensure that the information is readily available for all departments to use. If the new discipline succeeds, the industry will be much less able to benefit from de facto whitewashing.

Ignoring Expungeable Complaints

Even the best coordination depends on someone getting the information in the first place. The proposed Rule 2130 gives additional incentive to brokers and firms simply not to comply with the U-4 reporting rules for customer complaints other than statements of claim. Those rules that are already inadequately observed and even more rarely enforced.

Consider what can happen if an investor submits a written complaint to the firm that triggers a "Yes" answer on the broker's U-4 or U-5.[71] The firm aggressively and reflexively denies the complaint. The investor decides not to pursue the matter in arbitration. Maybe she got intimidated; maybe the claim wasn't large enough to attract competent counsel. The broker now has an unadjudicated ding on his record. Under the NASD's public disclosure rules, it will disappear from public view, though not from the permanent record, in 24 months.

But the broker doesn't want to wait. He wants it cleared off now, and he wants it permanently removed so that state regulators won't see it. What is to prevent him from filing a declaratory action in court seeking expungement on the grounds that the customer's "unsubstantiated" and unadjudicated allegations were "without factual basis"?

There will be only one voice speaking—the broker's—so the success rate of such actions should be high. The customer won't be there to contest the broker's self-serving rendition of the events. The NASD won't have any contrary facts of its own, and it certainly doesn't have the manpower to independently investigate the underlying merits of every investor complaint that brokers want to expunge. An affidavit from the firm averring that the customer's complaint was "without factual basis" will satisfy the provisions of Rule 2130 and should permit the expungement to go without NASD opposition.

Since uncontested expungement actions cost money and take time, why should the broker and firm report the customer's complaint at all? After all, it'll get expunged anyway if the customer doesn't follow through with a claim in arbitration. If there is an arbitration claim, it has to be reported under a different question, 14I(1), of Form U-4. So why bother? Just wait and see if you have to answer question 14I(1) and forget about reporting complaints on 14I(3).

Obviously, this behavior is wrong. But it is a low risk, high return, profit-maximizing choice. NASD enforcement of 14I(3) violations is virtually nonexistent. Even if the firm is caught, the penalties are negligible—generally less than the legal fees and the broker's lost production expended in formal expungement proceedings.

Protecting Producers Vs. Protecting Investors

A useful way to view the expungement question is as a choice of which mistakes are worse—Type I or Type II errors.

Type I: Accurate information about a broker or firm that was improperly expunged

Type II: Inaccurate information about a broker or firm that was unfairly retained without an adequate mechanism for correcting or removing it

From the perspective of securities industry members, it is clearly preferable to eliminate Type II errors. If a bad broker undeservingly gets a clean record, that's better than a good broker getting hurt by something false.

From the perspective of public protection, however, the scale is reversed. The NASD's and the state securities administrators' responsibilities under the securities laws require subordinating individual brokers' or firms' interests to the public welfare. Type II errors are less bad than Type I errors that can put the public in jeopardy.

A bad representative or brokerage firm can do enormous damage to many people. A bad representative or brokerage firm that was able to continue preying on the public because adverse information was wiped off their record is enough to show that such expungement cannot

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[71] Question 14I(3) of Form U-4, ver. 2002, requires disclosure of investment related, customer initiated written complaints alleging sales practice violations and damages of at least $5,000, or theft, forgery, misappropriation, or conversion. Current Forms U-4, U-5, BD, BDW, and associated instructions are available on the NASDR website at http://www.nasdr.com/3420d_adopted.asp.

be permitted.

Such examples abound. PIABA members all too frequently see recidivists with cleansed records. *Forbes* magazine reported on one such repeat-victimizer and the huge harm caused to the public:

> Investors in the last seven years have lost some $125 million in a Ponzi scheme allegedly conducted in part by brokers registered with a small California firm headed by Carl Martellaro. What many of those investors didn't know—in fact, couldn't know—was that Martellaro himself had been accused in a similar scheme five years ago. Then, two investors filed complaints claiming they had lost $1.75 million in investments with First Associated Securities Group, of which Martellaro was president. Why didn't investors know that? Because the information had been expunged - legally - from records of the [NASD]. Martellaro's attorney ... had offered to settle the earlier cases only if the investors allowed them to be deleted from Martellaro's record with the NASD.[72]

There is no justification for a system that allows such predators to continue operating. Type I errors of expunging genuine information and leaving the public at risk are far more objectionable than Type II mistakes.

NASD's "Balancing" Is Misguided

The NASD's rule filing and press release speak several times of trying to "balance" the interests of the public and securities regulators with brokers' interests. It claims that its duty as operator of the CRD

> requires the NASD to balance three competing interests: (1) the interests of NASD, the states, and other regulators in retaining broad access to customer dispute information to fulfill their regulatory responsibilities and investor protection obligations; (2) the interests of the brokerage community and others in a fair process that recognizes their stake in protecting their reputations and permits expungement from the CRD system when appropriate; and (3) the interests of investors in having access to accurate and meaningful information about brokers with whom they conduct, or may conduct, business.

This is fallacious. NASD's scale is out of whack.

There is no question that brokers deserve a fair process. However, expungement is not the proper way to achieve it. In seeking to satisfy the brokerage community, the NASD forgets that its statutory mandate is *investor protection*. The SEC recites constantly that the NASD's rules must "be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest."[73] Properly viewed, there can be no "balancing" act – the NASD's task in operating the CRD is to protect investors and the public interest. All other considerations must be subordinated to that responsibility.

> The bottom line is expungement is not required. The danger of expunging information which would benefit investors clearly offsets any detriment that a broker may suffer because the broker does not like the disclosure. The purpose of the CRD system is to protect the investing public. The function of NASDR in administering the system is to protect the investing public. Its objective should not be to protect the broker. Stockbrokers work in an extremely sensitive area, obtaining control over investors' personal assets, and the more information the investor can get about the broker, the better.[74]

The current rule is adequate to protect the CRD and public investors, as long as claimants' counsel understand and follow their legal and ethical duties.

Whitewashing Is Wrong

Is expungement a proper corrective

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[72] Michael Freedman, *The X-ed Out Files*, Fobes, Dec. 25, 2000, http://www.forbes.com/fobes/2000/1225/6616280a.html.

[73] E.g., Release No. 34-42402, 71 S.E.C. Docket 1483, *supra* note 11, citing Securities Exchange Act § 15A(b)(6).

[74] Laurence S. Schultz, Letter to Richard E. Pullano, NASDR, July 28, 2000. 5 U.S.C. 78o-3(b)(6).

solution for CRD errors? Despite militant advocacy from the SIA and the NASD's persistence in trying to create a framework that will satisfy the industry, a convincing case for expungement has not been presented.

Any kind of system that creates the possibility for respondents to strong-arm claimants in settlement negotiations is clearly beyond the pale. A system that gives respondents powerful incentives, as the proposed Rule 2130 does, to convert arbitration into federal style litigation—minus due process protections and the learnèd judge on the bench—should also be condemned.

We can again look to the public court system and the rights of ordinary citizens for guidance. As we've observed, citizens have no ability to "expunge" the historical facts of civil lawsuits that were filed against them, no matter how frivolous or vexatious the claim may have been. Why should stockbrokers—alone among American citizenry—be able to change public records to whitewash their personal history? No other person can do that in civil matters.

The purpose of CRD is to provide and preserve information, not to conceal or whitewash it. It is preposterous to imagine someone going to the Clerk of the Court and asking the court to expunge the fact that they were sued for things they did in their professional capacity.

Court records are open for full public inspection. This is a significant difference between the CRD and other public records. The public is not limited to reading a brief self-serving obfuscatory summary prepared by the defendant. "The public's right of access ... envisions a pervasive common law right to inspect and copy public records and documents, including judicial records and documents."[75] Interested persons—including the press—can study the underlying documents, including the pleadings, moving papers, affidavits, and other items in the record. If someone (a doctor, a lawyer, for example) has a blot on their record in the form of a lawsuit by an unhappy client, the public record contains full details. If the claim is frivolous or harassing, that point will be made in abundance in the record.

There are extremely valuable reasons for public access that the SROs as arbitration forum sponsors should seriously consider. SRO arbitration would improve immeasurably as a genuine socially responsible dispute resolution system if these fundamental principles were heeded.

> [T]he right of access strengthens confidence in the courts: The public's exercise of its common law access right in civil cases promotes public confidence in the judicial system by enhancing testimonial trustworthiness and the quality of justice dispensed by the court. As with other branches of government, the bright light cast upon the judicial process by public observation diminishes possibilities for injustice, incompetence, perjury, and fraud. Furthermore, the very openness of the process should provide the public with a more complete understanding of the judicial system and a better perception of its fairness. In addition, access to civil proceedings and records promotes public respect for the judicial process and helps assure that judges perform their duties in an honest and informed manner.[76]

In contrast to normal public records, investors examining the CRD know only that a complaint was filed. They do not know any of the genuine details, nor do they have any means of ascertaining the quality and seriousness or frivolousness of the claims. This, too, is a self-inflicted problem created by the securities industry, by insisting that all disputes by resolved by arbitration and by refusing to make arbitration pleadings and related documents available for investors to examine.

By compelling arbitration, the securities industry successfully hides almost all evidence of its misconduct from the public record and public inspection. That secrecy is incalculably valuable to the industry. It has no right to ask for yet more exceptions to fundamental American principles by demanding to be able to rewrite history in its own favor.

The industry has already determined that keeping secret all but the iceberg's tip of its wrongful conduct is more important than giving public access to documents correcting or explaining the occasional mistakes that may appear in the CRD records of individual members or associated persons. Having thus created a system that already gives it enormous benefits at the expense of investor protection, the securities

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[75] *In re Cednat Corp.*, 260 F. 3d 183,192 (3rd Cir. 2001) (internal quote marks omitted)..

[76] *Id.* (Internal quote marks and citations omitted).

industry is not entitled to yet another exceptional procedure of unwriting history, whitewashing employees' records, and allowing bad brokers and members to continue to prey on an unsuspecting public.

LEGAL ETHICS: JUST SAY "NO"!

Expungement is not and should never be a bargaining chip in settlement. Unable to get expungement under the existing NASAA criterion of "factual impossibility", the brokerage industry has taken matters privately into its own hands and for a number of years has been abusing the issue of expungement by using it as a settlement demand.

Both the sole standard at present (factual impossibility) and the proposed criteria (no factual basis, unable to state a claim or frivolous claim, defamatory filing) show clearly that your decision is not a matter of business negotiation, but instead one of professional responsibility. A decision regarding expungement is not your client's—it's yours. If the currently proposed criteria are adopted, your answer must be **NO** unless the situation meets one of those criteria. Until then, your answer must be **NO** unless it satisfies the standard of "factual impossibility."

Ethical and professional responsibility considerations prevent expungement from even getting to the settlement table just as surely as they prevent demands or agreements to limit lawyers' future practice.[77] Lawyers who say that they'll negotiate over expungement because they're hired to represent their client, not the investing public, are missing that essential point. It's not a question of "getting the best deal for your client" – the issues are much bigger than that.

Unless you have made a genuine mistake, you must not agree to an expungement in settlement, since it means you agree that the claim was baseless, unmeritorious, even frivolous, *ab initio*. This is not the client's decision—it is yours as the lawyer. You signed the pleading, and in doing so you warranted that the allegations were well-founded in fact and law and that the complaint was not presented for an improper purpose. If you did not have adequate basis for that belief, you would rightly be subject to sanctions and/or discipline.

If you did not file a frivolous, meritless, baseless claim, you cannot agree to expunge in settlement. To expunge the record means that you now believe, and are willing to state under oath, that the broker did nothing wrong and that your complaint against him was totally improper. That would be a lie and an ethics violation. As we saw above, the NASD or the respondents may ask you for such a sworn declaration that can end up being presented to a court.

Moreover, the lie is not just between the parties—you would be lying to the court. There is never an excuse for that.

Further, as long as you cannot state, under oath, that your original claim was wholly without merit, by agreeing to an expungement you are falsifying a public record. As we saw above, any claimant's counsel who grants such an affidavit or permits respondents' counsel to make such representations on her behalf commits a fraud on the court, violates the rule requiring candor toward the tribunal, and participates in a conspiracy to falsify or tamper with public records. Perjury carries civil and criminal penalties, as does tampering with public records. No lawyer who values his or her liberty, property, ethical obligations, and license to practice law can participate in such a scheme.

If perjury and tampering with public records weren't enough, remember that federal and state regulators use the CRD as their primary source of information about registered persons. Filing false information or submitting documents with material omissions to the CRD is a federal crime. Individuals deliberately submitting inaccurate information have been criminally prosecuted for federal mail fraud, 18 U.S.C. § 1341, and for making a false statement to government, 18 U.S.C. § 1001.[78] Do you really want to lie on behalf of the

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[77] Compare your state's version of ABA Model Rule 5.6.

[78] *U.S. v. Turner,* 22 Fed.Appx. 404, 2001 WL 1216987 (6th Cir. 2001). Sixth Circuit rules permit citing unpublished opinions if a party believes that it "has precedential value in relation to a material issue in a case, and that there is not published opinion that would serve as well...." U.S.Ct. Of App. 6th Cir. Rule 28(g), 28 U.S.C.

respondent broker and expose yourself to such penalties?

Under no stretch of any imagination can such behavior be justified or condoned. A lawyer's responsibility to advocate zealously for his client does not permit him to step outside the bounds of the law.[79]

> Attorneys are officers of the court and their first duty is to the administration of justice. Whenever an attorney's duties to his client conflict with those he owes to the public as an officer of the court, he must give precedence to his duty to the public. Any other view would run counter to a principled system of justice.[80]

No amount of self-delusion to encourage settlement will suffice to change that reality.

These obligations make the decision easy—it's out of your hands, and out of your clients' hands. We cannot agree to acts that are illegal or contrary to the rules of professional conduct.

Another consideration should also give pause, though if violating your professional responsibilities and participating in criminal acts don't worry you, this won't either. By agreeing to an unmerited expungement, you will be lying to the entire investing public of America. You would be telling them—falsely—that the complaint you signed against this broker was meritless, and that they can confidently make a decision to invest with him knowing that your earlier allegations were so baseless that they deserved to be wiped off the record.

You know that's not true, the broker knows it, his lawyer knows it, and the firm knows it. But the innocent folks out there that you'd be lying to don't know it. How will you feel when they are hurt by your deception? And if you're inclined to say that you're not hired to represent the public, remember the lives and savings that have been wrecked by brokers like Carl Martellaro. Think of your own clients, put a face to the hurt, and realize that you may have enabled it.

When respondents come demanding expungement, JUST SAY NO!

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[79] See *State v. Turner*, 217 Kan. 574, 538 P.2d 966, 87 A.L.R.3d 337 (Kan. 1975); *Hitch v. Pima County Superior Court*, 146 Ariz. 588, 708 P.2d 72 (Ariz. 1985); *State ex rel. Oklahoma Bar Ass'n v. Tweedy*, 52 P.3d 1003 (Okla. 2000). The duty of the lawyer as an advocate is to represent his client "zealously within the bounds of the law." C.P.R. Canon 7. We are not discussing conscientious civil disobedience here, but note that even in such cases, the lawyer cannot act with impunity but must be prepared to accept the legal consequences of his acts.

[80] *Van Berkel v. Fox Farm and Road Machinery*, 581 F.Supp. 1248, 1251 (D.Minn. 1984), citing *Theard v. U.S.*, 354 U.S. 278, 281 (1957).

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Expungement Requests in Settlement Negotiations: Consequences if You Don't Just Say No

Steven B. Caruso

Steven B. Caruso received his BA from American University (1977) and his JD degree from Hofstra University (1980). He is the Resident Partner in the New York City office of Maddox Hargett & Caruso, P.C. and concentrates his practice on the representation of public investors in arbitration and litigation proceedings. Mr. Caruso is admitted to the New York State Bar, United States Supreme Court, United States District Court for the Southern and Eastern Districts of New York, United States Tax Court, and the United States Court of Appeals for the Second Circuit. He has been a member of the PIABA Board of Directors since 2002, currently serves as President of the Association, and may be contacted at either sbcaruso@aol.com or 212-837-7908.

On December 16, 2003, the Securities & Exchange Commission approved NASD Conduct Rule 2130 which concerns the expungement of customer dispute information from the Central Registration Depository (CRD) system.[1]

This rule, which is applicable to any customer complaint, arbitration proceeding or civil lawsuit *filed on or after April 12, 2004*, including settlements arising from any of the same, requires that an arbitration panel can only grant a request for expungement, contained in either a settlement agreement and/or a stipulated award, if the panel makes an *affirmative* finding that the subject matter of the customer dispute meets one or more of the three (3) specific standards that are set forth in NASD Conduct Rule 2130.

Standards for Expungement

NASD Conduct Rule 2130 states that, in order for an arbitration panel to grant a request for expungement that has been presented by either a broker-dealer and/or an associated person, the arbitration panel must make an affirmative finding that:

(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.

Subsequent to the approval of this rule, the NASD also issued a number of publications[2] and/or interpretations which were intended to provide arbitration panels and parties with further guidance on the applicability of these specific standards.

For example, in *Rule 2130 Frequently Asked Questions*,[3] the NASD has stated that the standard which would require that an arbitration panel be able to make an affirmative finding that "the claim, allegation or information is factually impossible or clearly erroneous," would be applicable to those circumstances when "an individual who was named in

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[1] *See*, SEC Order Granting Approval of Proposed Rule Change and Amendment No. 1, thereto, and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2, thereto, Relating to Proposed NASD Rule 2130 Concerning the Expungement of Customer Dispute Information from the Central Registration Depository System, 68 Fed. Reg. 74667 (Dec. 24, 2003).

[2] *See, e.g.*, NASD Notice to Members 04-16 (Mar. 2004).

an arbitration claim ... was not employed or associated with the member firm during the relevant time."

Similarly, for the standard which would require that an arbitration panel be able to make an affirmative finding that "the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds," this standard would be applicable to those circumstances when "the registered person was not involved" in the alleged misconduct, *provided however*, "the dismissal of a claim, by itself, would not be a sufficient basis for ordering expungement."

And finally, for the standard which would require that an arbitration panel be able to make an affirmative finding that "the claim, allegation, or information is false," this standard would be applicable to those circumstances where the arbitration panel, after having had the opportunity to "assess the evidence in the case," decides that the claim, allegation or information is just plain false.

Expungement in the Context of Settlement

In the context of the settlement of a customer dispute (complaint, arbitration, civil lawsuit or otherwise), if, in fact, the associated person has been named as a respondent or defendant in the underlying proceeding, there will often be a point in time when the subject of expungement will be raised as a component of the settlement negotiations by opposing counsel.

More often than not, counsel for customers are being "orally" asked to consent to the expungement of the dispute, in a stipulated arbitration award, on the basis of the Rule 2130(b)(1)(C) standard which states that "the claim, allegation, or information is false."

There is a very good reason as to why this standard has become the "flavor of the month" in the context of expungement requests - it places all of the burdens and potential ramifications solely on the lap of counsel for the customer.

For aside from the fact that any expungement, except in the most narrowest of circumstances, would undermine the integrity of the entire CRD system and would also potentially mislead future investors who may inquire as to the "complaint history" of a registered representative, there are severe potential additional consequences for any attorney who agrees to the specified wording that "the claim, allegation, or information" that he or she has previously filed "is false."

• **Practical Consequences**: Since all stipulated awards are publicly available on the website of NASD Dispute Resolution, it will only be a matter of time before you are facing a dispositive motion in a *future* case where counsel for the brokerage firm and/or associated person will state to the panel that you have a "track record" of having filed claims which are admittedly "false."

It should be anticipated that the contemplated motion will perhaps even include copies of those stipulated awards which, although inadmissible, will be read (and most certainly remembered) by the members of that future arbitration panel.

• **Legal Consequences**: It is clear that any attorney who admits to having filed claims which were "false" also exposes himself or herself to severe sanctions from the bar association which could potentially lead to a disciplinary proceeding and disbarment.

For example, using the Code of Professional Responsibility of the State of New York[4] as a model for the similar provisions in almost

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[3] *See*, Rule 2130 Frequently Asked Questions, available at http://www.nasd.com/RegulatorySystems/CRD/FilingGuidance/NASDW_005224 (visited Jul. 17, 2007).

[4] See, New York Lawyer's Code of Professional Responsibility, available at http://www.law.cornell.edu/ethics/ny/ code/NY_CODE.HTM (visited Jul. 17, 2007).

every other state in the country, the submission of a false claim or allegation to an arbitration "tribunal" (whether in the context of a Statement of Claim or a Stipulated Award) could constitute an indefensible violation of the following Ethical Considerations and/or Disciplinary Rules:

> EC 7-26: The law and Disciplinary Rules prohibit the use of fraudulent, false, or perjured testimony or evidence. A lawyer who knowingly participates in introduction of such testimony or evidence is subject to discipline. A lawyer should, however, present any admissible evidence the client desires to have presented unless the lawyer knows, or from facts within the lawyer's knowledge should know, that such testimony or evidence is false, fraudulent, or perjured;
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> DR 7-102(A): In the representation of a client, a lawyer shall not: file a suit, assert a position, conduct a defense, delay a trial, or take other action on behalf of the client when the lawyer knows or when it is obvious that such action would serve merely to harass or maliciously injure another; knowingly advance a claim or defense that is unwarranted under existing law, except that the lawyer may advance such claim or defense if it can be supported by good faith argument for an extension, modification, or reversal of existing law; conceal or knowingly fail to disclose that which the lawyer is required by law to reveal; knowingly use perjured testimony or false evidence; knowingly make a false statement of law or fact; or counsel or assist the client in conduct that the lawyer knows to be illegal or fraudulent;
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> DR 7-102(B): A lawyer who receives information clearly establishing that: the client has, in the course of the representation, perpetrated a fraud upon a person or tribunal shall promptly call upon the client to rectify the same, and if the client refuses or is unable to do so, the lawyer shall reveal the fraud to the affected person or tribunal, except when the information is protected as a confidence or secret; and a person other than the client has perpetrated a fraud upon a tribunal shall reveal the fraud to the tribunal; or
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> EC 8-5: Fraudulent, deceptive, or otherwise illegal conduct by a participant in a proceeding before a tribunal or legislative body is inconsistent with fair administration of justice, and it should never be participated in or condoned by lawyers. Unless constrained by the obligation to preserve the confidences and secrets of the client, a lawyer should reveal to appropriate authorities any knowledge the lawyer may have of such improper conduct.

• **Collateral Consequences**: Finally, the collateral consequence of having an admission of an attorney having filed claims which are admittedly "false" on the public record, must be considered in the context of not only applications for future bar or court admissions, but on the applications and certifications that are normally associated with the initial application for, and/or renewal of, legal malpractice insurance coverage.

Conclusion

In summary, while the ability to obtain an expeditious settlement of the claims of a client may suggest that consent to expungement is an economical means to achieve a desired result, careful consideration must be given to the potential consequences that could evolve from that "short-sighted" approach.

The solution to this issue is really quite simple - just say no.