29TH ANNUAL MEETING

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PIABA 29th Annual Meeting

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PIABA 29th Annual Meeting Speaker Biographies

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Jeff Abrams has been an attorney for over 40 years, and a mediator/arbitrator for the past 36 years. He is an active FINRA mediator and arbitrator (often serving as Chair). His practice is dedicated exclusively to mediation and arbitration (100% ADR). Jeff specializes in securities, complex commercial, employment, healthcare, and general business disputes. He is passionate about mediation.

Jeff is a pioneer in the mediation field. He served on the legislative task force that drafted the landmark Texas ADR law. He worked closely with FINRA (then NASD) to design its national mediation program and created a renowned mediator training program. Jeff travels nationwide on mediation assignments. Through use of videoconference technology, Jeff has mediated across time zones in the United States and abroad. He has been recognized as an expert in virtual mediations, using Zoom as a platform. Jeff is a frequent speaker at legal conferences on mediation advocacy, negotiation strategy, and the technology of virtual mediations.

Jeff lives in Dallas with his wife Angela and his dog Alea. He has two children and four grandchildren. Jeff can be reached at work 972-702-9066, on his cell 214-289-4427, by email jeff@abramsmediation.com, or through his company website www.abramsmediation.com. The website has an interactive online calendar for ease of scheduling.

Kathy S. Adams, Esq.
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Kathy Adams is the owner of Kathy Adams Dispute Resolution Services, a mediation and consulting firm focused on disputes involving the financial services industry. Her wide-ranging experience includes investor-initiated disputes, wrongful termination and U-5 defamation matters, harassment and discrimination cases, intra-industry disputes, protocol issues, and trust/estate contests. Kathy brings an evaluative, litigation-focused approach to mediation, along with the creativity needed to resolve cases that are especially difficult or involve uncommon challenges.

With more than 20 years of experience in and around the financial services industry, Kathy brings a wealth of knowledge and a variety of perspectives and insights to the cases she mediates. As an advocate, Kathy successfully litigated to award claims totaling millions of dollars and negotiated the settlement of hundreds of cases. As in-house counsel for a global brokerage firm, she gained valuable insight into the inner workings of the financial services industry. As a litigation consultant, she has worked through detailed case evaluations with attorneys for claimants/plaintiffs and respondents/defendants.

Participants in mediations prefer a neutral who understands their circumstances, including how and where they live. Kathy has lived and worked in most regions of the country and enjoys mediating in all locations. Her geographic diversity and understanding of unique regional culture has proved invaluable in resolving cases across the country, and especially in cases venued between the coasts.

Kathy is licensed to practice law in both California and Minnesota and is an active member of the ABA Litigation Section's ADR and Securities Arbitration committees and the Southeastern Women in Financial Services (SWIFS). She is a sought-after speaker on negotiation and settlement strategies, financial elder abuse, behavioral economics, and the benefits of bringing diverse views and approaches to mediation.

An avid runner, Kathy competes in races across the country. She recently completed her second Boston Marathon in April 2019.

Mediation Services Offered Nationwide

Ohia A. Amadi, Esq.
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Mr. Ohia Amadi has extensive experience representing plaintiffs and defendants in disputes involving securities claims under the Securities Act, the Securities Exchange Act, the Investment Advisers Act and various state Blue Sky laws. He regularly represents clients in the financial services and securities industries, such as registered investment advisers (RIAs), broker-dealers, independent broker-dealers and individual financial advisers in federal and state courts, arbitration forums and administrative, regulatory and enforcement forums by government agencies and self-regulatory organizations, such as the SEC, FINRA, the California Department of Business Oversight and the California Department of Insurance.

Mr. Amadi also advises clients across industries in business disputes involving professional malpractice; fraud; breach of fiduciary duty; breach of contract; unfair competition; economic interference; trade secret misappropriation; trademark and copyright infringement; non-compete, non-solicitation, and confidentiality agreements; business divorces; control disputes; shareholder derivative actions; insurance coverage disputes; defamation and First Amendment issues; Civil Rights; trusts and estates; real estate and other issues.

As a Certified Information Privacy Professional (CIPP/US), Mr. Amadi assists clients with managing and avoiding disputes stemming from complex privacy laws and regulations across various industries with emphasis in the financial services and securities sectors. Mr. Amadi also has experience making information requests pursuant to the Freedom of Information Act (FOIA) and the California Public Records Act in the litigation context.

Mr. Amadi is a graduate of Yale University, where he double-majored in Mechanical Engineering and Economics, and Harvard Law School. Prior to law school, Mr. Amadi was an investment banking analyst in Lehman Brothers' Global Restructuring and M&A Groups in New York City where he advised companies, sovereign governments, and government agencies on matters such as distressed bonds, balance sheet restructuring, rescue financings, Chapter 11 creditor advisory, 363 assets sales, and distressed M&A.

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Derek C. Anderson concentrates his practice in the areas of securities litigation and regulation, complex commercial and business litigation, and professional liability litigation. He represents a wide variety of professionals, fiduciaries, and financial services clients, including national, regional, and independent broker-dealers and their registered representatives, banks, registered investment advisors and their representatives, pension advisory firms, attorneys, accountants, and corporate directors and officers in litigation and regulatory matters throughout the United States. His practice is devoted to litigation in federal and state court and arbitration of securities cases throughout the United States.

Mr. Anderson received his B.A. from Duke University (1991) and his J.D. from Washington University School of Law in St. Louis (1994). He began his legal career as a Deputy District Attorney in Portland, Oregon before entering private practice. Mr. Anderson is a member of the Colorado, California, Florida, Massachusetts, and Oregon bars, and is admitted to practice before the United States Supreme Court, the United States Court of Appeals for the Tenth Circuit, the United States Court of Appeals for the First Circuit, the United States District Court for the District of Colorado, and the United States District Court for the District of Massachusetts. He is also a member of the Securities Industry and Financial Markets Association (SIFMA) - Compliance and Legal Division, and speaks frequently around the country regarding securities arbitration related topics.

Mr. Anderson is rated **AV by Martindale Hubbell**, which is the highest possible rating, reflecting both legal ability and professional ethics. This rating is a reflection of his experience, knowledge, and commitment to his clients.

Stefan Apotheker, Esq.
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Stefan Apotheker is an "AV" rated trial attorney at Erez Law, PLLC in Miami, Florida. His practice focuses on securities arbitration and litigation. The entirety of Mr. Apotheker's legal career has been dedicated exclusively to obtaining justice for investors who have been the victim of investment fraud and other broker-dealer misconduct. Mr. Apotheker has

worked on well in excess of 1,000 FINRA arbitration cases. He has successfully obtained numerous FINRA arbitration awards in favor of investors, including multiple awards of rescission, attorney's fees, punitive damages and recoveries for investors with a net-out-of-pocket gain. Mr. Apotheker has been a member of the Public Investors Arbitration Bar Association since 2008 and is a frequent speaker at securities conferences on issues related to trial practice and FINRA arbitration proceedings. He has authored several articles on issues related to securities arbitration. His most recent article "*Production of Regulatory Investigation Documents in FINRA Arbitration*" was published in Volume 26, No. 3 of the PIABA Bar Journal (2019). Mr. Apotheker graduated *cum laude* from the University of Miami School of Law in 2004. He is admitted to practice law in the State of Florida and the U.S. District Court for the Southern District of Florida.

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Securities attorney Bob Banks has been practicing law for 36 years, and is a nationally recognized leader in investor rights law. His cases have been featured in The New York Times, Wall Street Journal, Investment News, Business Journal, The Oregonian, and a host of other publications. In addition to litigating securities claims he is an adjunct professor at Lewis and Clark Law School.

Bob serves a broad array of individuals, organizations and groups who have been victims of negligent advice and fraudulent conduct by brokers, accountants, and other lawyers. His cases involve the violation of securities regulations, Ponzi scheme clawback litigation, and legal malpractice cases involving corporate or securities law issues. He serves on FINRA's National Arbitration and Mediation Committee, representing investor interests, and has chaired its Rules and Procedures subcommittee, which writes the rules governing FINRA arbitration. He is a past president and current member of the Board of Directors of the Public Investors Arbitration Bar Association, and is one of only a handful of board members ever honored with Director Emeritus status.

Hugh D. Berkson, Esq.
McCarthy, Lebit, Crystal & Liffman
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Hugh D. Berkson is a Principal attorney with McCarthy Lebit Crystal & Liffman Co., L.P.A., in Cleveland, Ohio, and focuses his practice in securities arbitration and litigation. After gaining extensive trial experience in both business and personal injury litigation, he began representing injured investors. Hugh tries and arbitrates investment-related cases and performs much of the required technical analysis.

Hugh obtained a business degree in Finance from the University of Texas at Austin and is a graduate of Case Western Reserve University School of Law, where he was a member of the Order of the Barristers and received both the American Jurisprudence Award (National Mock Trial) and the Jonathan M. Ault Mock Trial Prize. He later served as an Adjunct Professor at Case Western Reserve University School of Law, where he taught trial practice. Hugh is "AV Preeminent" rated by Martindale Hubbell, has been ranked as an Ohio "Super Lawyer" every year since 2013, and maintains a 10.0 "Superb" rating on Avvo.

Hugh is a past president of PIABA and has served on PIABA's Board of Directors since 2011. He has used his time on the Board to fight the problems related to unpaid arbitration awards, having written and published a report during his term as president: *Unpaid Arbitration Awards – A Problem The Industry Created – A Problem The Industry Must Fix*, and a follow up published in February of this year: *Unpaid Arbitration Awards – The Case For An Investor Recovery Pool*. He also wrote, with Marnie Lambert, a piece concerning the ongoing problems with BrokerCheck, titled *BrokerCheck – The Inequality of Investor Access To Information Remains Unabated – An Update To PIABA's 2014 Report.*

Richard W. Berry, Esq.
Executive Vice President and Director of FNRA Dispute Resolution
New York, New York

Richard W. Berry is Executive Vice President and Director, Office of Dispute Resolution.

Prior to serving in this capacity, Mr. Berry was Senior Vice President, Dispute Resolution. In that role, he oversaw the four regional offices—New York, Boca Raton, Chicago and Los Angeles—and the New York Case Administration unit.

Mr. Berry joined FINRA, then NASD, in 1995 as head of Dispute Resolution's Los Angeles satellite office. In 2001, he was named Director of Case Administration in the New York City office. Mr. Berry serves as Executive Sponsor of the FINRA Parents Network, one of FINRA's employee resource groups.

Prior to joining FINRA, he taught American law for one year in Budapest. Mr. Berry began his career practicing law in San Francisco. He is a graduate of the University of California at Santa Barbara and Hastings College of the Law. Mr. Berry is a member of the California Bar.

Alan J. Besnoff, CFP, ChFC, CLU
Securities Expert Witness & Litigation Support, LLC
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Alan J. Besnoff, CFP, ChFC, CLU is the founder of Securities Expert Witness & Litigation Support, LLC, and provides litigation consulting services and expert testimony for matters involving customer disputes and employment issues within the financial services industry.

Mr. Besnoff's expert engagements typically involve sales practices and violations of rules and industry standards in the areas of securities, life insurance and annuities, as well as supervisory and U-5/wrongful termination matters.

Alan Besnoff has over 30 years of experience within the industry, primarily in supervisory and leadership positions.

Mr. Besnoff has passed FINRA registration examinations for Series 6, 63, 65, 7, 26, and 24, as well as state licensing examinations for Life Insurance & Annuities, Disability Insurance, Long Term Care Insurance, Variable Life Insurance and Variable Annuities.

Professional designations held by Mr. Besnoff include:
Certified Financial Planner, CFP
Chartered Financial Consultant, ChFC
Chartered Life Underwriter, CLU

Mr. Besnoff has developed and taught compliance training programs, and has initiated and implemented policies and procedures to assure branch offices, financial advisors, registered representatives, brokers and managers are in compliance with FINRA regulations, and industry standards. He has also taught securities, financial planning, insurance & annuities, and risk management at multiple universities and to financial advisors and managers throughout the financial services industry.

Industry leadership roles held by Mr. Besnoff include having served as President of the National Association of Insurance and Financial Advisors (NAIFA) in Connecticut.

In addition to providing expert consulting and testimony, Mr. Besnoff is currently active as a Director and Committee Chair of Securities Experts Roundtable, and as a FINRA Arbitrator.

Mr. Besnoff has been appointed by the CFP Board of Standards, and is currently serving as a Commissioner on the Disciplinary and Ethics Commission.

Alan Besnoff, CFP, ChFC, CLU may be reached at Abesnoff@AJBExpertWitness.com or 603-641-6469. Additional detail and CV may be found at www.AJBExpertWitness.com.

Michael Bixby, Esq.
Levin Papantonio et al.
Pensacola, Florida

Michael C. Bixby focuses his practice on representing customers and investors in securities and investment fraud litigation. He has successfully represented hundreds of investment fraud victims around the country in a variety of forums including arbitrations, and state and federal courts. Mr. Bixby takes pride in fighting to achieve justice for his clients through litigation, mediation, or trials and arbitrations.

Mr. Bixby has successfully achieved multiple Verdicts and Judgments in excess of $1mn in Securities Fraud Arbitrations and in Florida courts. Last year in a case as sole trial counsel, he obtained a FINRA Award of over $1.1mn against Berthel Fisher and its Control Persons, the largest FINRA Customer Award ever against Berthel Fisher. The award included attorney's fees, costs, and punitive damages and Mr. Bixby's clients were able to put the

entirety of their principal losses back in their pockets. Mr. Bixby has also obtained multiple additional awards of full well-managed damages, in addition to fees and costs. For instance, Mr. Bixby obtained an award along with his partners of over $19 million against UBS Financial Services (including attorney's fees and costs) in a Puerto Rico Fund and Bond case.

Mr. Bixby graduated from Wake Forest University School of Law. He is admitted to practice law in the State of Florida and the U.S. District Court for the Northern District of Florida. He has been a member of PIABA since 2014 and has served on the Membership Committee and Arbitration Committee.

Celiza "Lisa" Braganca, Esq.
Braganca Law LLC
Chicago, Illinois

Lisa recovers investment losses and represents individuals and firms in SEC, state, and FINRA regulatory investigations.

Lisa served as a Branch Chief in the Division of Enforcement of the Chicago Office of the Securities & Exchange Commission, where she handled investigations of accounting fraud, Ponzi schemes, insider trading, churning, and unsuitable investments. Since leaving the SEC, Lisa has helped recover millions of dollars in investment losses in court and in FINRA arbitrations. She has represented individuals and entities in numerous investigations by the SEC and other regulators of cryptocurrencies and token offerings, insider trading, financial fraud by public companies, and other conduct. While at the SEC, Lisa collaborated with the DOJ in investigating $2 billion in losses arising out of subprime auto lender Mercury Finance Company's cooking the books and investigated Foreign Corrupt Practices Act violations arising out of bribery of Haitian customers officials. Both resulted in criminal convictions of CEOs and other senior executives.

Lisa writes and speaks about elder financial exploitation, securities and cryptocurrency regulation, and recovering investment losses including the following: St. John's Law School Securities Arbitration Clinic (guest lecturer); 2019 Concordia University elder financial abuse program; CBA program, Truth Without Proof - getting blockchain transactions into evidence; co-author of Truth Without Proof article on Law360; Cryptocurrencies and Tokens: What are they and who regulates them, co-author with Lou Straney, PIABA Bar Journal, Vol. 25, No. 1 (2018); PIABA and CBA meetings and programs on cryptocurrency and token regulation, investor protection, and behavioral finance; American Bar Association TechShow 2019 – speaker on cryptocurrency and token regulation; National Association of Elder Law Attorneys (NAELA) training on elder abuse by financial advisors; Chicago Bar Foundation / NITA trial advocacy and deposition skills programs instructor.

Lisa serves as Chair of the CBA Securities Law Committee and is a member of the Women's White Collar Defense Association (WWCDA), the CBA Financial and Emerging Technology Committee, and the Trial Bar of the U.S. District Court for the Northern District of Illinois. She has a B.A. (with honors) and J.D. / M.B.A. (Order of the Coif, honors) from the University of Chicago.

John S. Burke, Esq.
Higgins & Burke, PC
St. Charles, Illinois

I am a second generation attorney who grew up reading depositions transcripts. I always believed I would pursue a career in the law. My career has been strongly devoted to serving and protecting individuals in financial and securities matters, including stock broker fraud, insurance fraud, consumer fraud, securities litigation, breach of fiduciary duty, and other financial frauds. Prior to embarking on my legal career I was a successful stock broker for a national firm. I entered law with a promise to my clients that I would continue to serve investors by using my experience in the securities and insurance business to help investors who were defrauded by those individuals and industry practices that I found unconscionable. Nearly twenty-five years I have been practicing law in securities matters before FINRA, NASD, NYSE, and other SRO arbitration panels as well as in state and federal courts nationwide.

Melanie S. Cherdack, Esq.
Genovese, Joblove & Battista, PA
Miami, Florida

Melanie Cherdack is of counsel in the Miami, Florida office of Genovese Joblove & Battista, P.A. Prior to this, she served as Assistant General Counsel in the litigation department of PaineWebber Inc. (now UBS). She graduated with honors from the University of Florida College of Law where she was a Senior Editor on the Florida Law Review. She has published numerous articles and has lectured before many legal and professional organizations on issues related to securities arbitration. In the past, Ms. Cherdack served as an arbitrator trainer for FINRA (formerly NASD). She has been a FINRA arbitrator since 1994, as well as an NFA arbitrator, as has served as a panel member or chair on dozens of arbitration actions. Ms. Cherdack primarily represents individual and institutional investors in securities arbitrations, and has extensive experience in representing investors from Latin America, the Caribbean, and most recently has been involved in many FINRA arbitrations in Puerto Rico. Additionally, she and her law firm represent receivers and trustees appointed to recover money for victims of securities fraud, Ponzi schemes and financial fraud.

Ms. Cherdack also represents securities brokers in employment disputes against their firms. Additional information can be found on her website www.investorfraudlaw.com or at www.gjb-law.com. She can be contacted at mcherdack@GJB-law.com.

Jason Doss, Esq.
The Doss Firm, LLC
Marietta, Georgia

Jason Doss is the owner of The Doss Firm, LLC, an Atlanta-based law firm devoted to representing consumers across the country in a variety of areas including investment disputes and consumer class action litigation. He has helped recover millions in damages from well-known financial services companies on behalf of individual investors who lost their life savings due to bad investment advice and in some cases, financial fraud.

Notably, Mr. Doss successfully represented a large of group of investors who were defrauded in a Ponzi scheme at the Atlanta-based mega-church, New Birth Missionary Baptist Church. The case was deemed as one of the largest church-based affinity fraud schemes in American history, received national media attention, and was featured on the popular ABC show Nightline. In addition, Jason Doss was co-lead counsel on two separate consumer class action cases against two of Georgia's largest natural gas providers, obtaining class settlements totaling $18.5 million on behalf of over 750,000 Georgia residents for alleged overcharges.

Jason Doss is past-President and a current Board of Directors member of Public Investors Arbitration Bar Association (PIABA). PIABA is an international bar association devoted to protecting the rights of the investing public. Mr. Doss is also a founding board member and current President and CEO of The PIABA Foundation, a charitable organization devoted to promoting investor education.

Jason Doss believes that the best way to avoid becoming a victim of consumer fraud and/or investment abuse is through education. To help prevent investment and consumer abuse, Mr. Doss co-authored a book with best-selling author and investment adviser Frank Armstrong III, entitled The Retirement Challenge: Will You Sink or Swim? It was released in January 2009 and is currently sold at book stores across the country.

In addition, Mr. Doss serves as an adjunct professor at Georgia State University College of Law and helps run the Investor Advocacy Clinic, a law clinic allowing law students the opportunity to provide supervised representation of aggrieved investors who cannot otherwise obtain and/or afford an attorney to represent them in disputes with financial advisors and brokerage firms.

Mr. Doss has also written and lectured on legal topics related to securities arbitration. Jason Doss co-authored his second book entitled, A Practitioner's Guide To Securities Arbitration, which was published by the American Bar Association and released in March 2013. That book is used at many law schools across the country as a primary text to teach students about securities arbitration practice and procedure.

Jason Doss co-authored two Georgia Bar Journal articles, Holmes v. Grubman: The Supreme Court of Georgia Balances Financial Advisor Common Law Liability (February 2011) and Georgia Securities Act - Let the Buyer Beware (June 2005). He has also published several law articles on investment-related topics in the PIABA Bar Journal. Notably, in 2014, while PIABA President, Mr. Doss released two reports entitled The Inequality of Investor

Access To Information (March 2014) and The Importance of Arbitrator Disclosure (October 2014). Both reports received national news coverage from publications such as the USA Today, Wall Street Journal, the New York Times, and Reuters. Those publications have also relied on Mr. Doss for analysis of other investment related legal issues.

Jason Doss has also been politically active in Washington D.C. over the last several years in raising awareness and advocating in favor of law designed to protect investing public.

Mr. Doss earned his J.D. from Florida State University in 2002 and his B.A. from the University of Florida in 1997. He is admitted to the bars of Florida and Georgia as well the 11th Circuit and other federal district courts.

Laura Dunning, Esq.
***Of Counsel*, Levin Papantonio, et al.**
Pensacola, Florida

Laura Sherling Dunning is an attorney in the Securities and Business Litigation practice group of Levin Papantonio. Ms. Dunning has represented more than 500 victims of securities fraud in the Financial Industry Regulatory Authority (FINRA) arbitration and in state and federal court, recovering millions in losses for clients, including sophisticated and institutional investors. Since 2010, Ms. Dunning has been repeatedly recognized as an Alabama and Midsouth Super Lawyer Rising Star in Securities Litigation. In addition to her securities practice, she represents hundreds of governmental entities in national litigation related to the opioids crisis and serves as a co-chair of the Law and Briefing committee and a co-chair of the ESI Logistics committee for the National Prescription Opiates MDL.

Ms. Dunning has particular expertise in product case discovery disputes in FINRA arbitration and discovery related to ESI. She is a frequent speaker on issues confronting the securities industry, including FINRA arbitration procedures, arbitrator selection, electronic discovery, and how to vacate and protect arbitration awards, and has served as a guest lecturer at the University of Alabama School of Law.

Ms. Dunning graduated *cum laude* from Rhodes College and received her juris doctor from the University of Alabama School of Law, where she served as a senior editor on the Alabama Law Review and as a nationally competing member of the Campbell Moot Court Board. She and her husband have two young children and reside in Birmingham, Alabama, where Ms. Dunning serves on her local church council and works to support community organizations, including the YWCA, for which she is a former board member, and Family Promise, which provides housing for homeless families.

Michael S. Edmiston, Esq.
Jonathan W. Evans & Associates
Orange, California

Michael S. Edmiston is an attorney at Jonathan W. Evans & Associates in Studio City, California. He has practiced with the firm since 2006. Prior to entering private practice, Michael served as a Senior Staff Attorney with NASD Dispute Resolution (now FINRA) in Los Angeles, California (1997-2001), and as a Business Manager with JAMS in Dallas, Texas and Orange, California (2001-2005).

His practice focuses on representing investors before FINRA, private commercial arbitration forums, and in state and federal court. His work continues to result in successful recoveries for clients by way direct negotiation, mediation, and contested arbitrations. Michael volunteers his time to Community Legal Aid SoCal working with senior citizens in a variety of civil and administrative matters.

In 2015, Michael became a Director of PIABA and will be serving as its EVP for 2020-2021. He previously served as the organization's Treasurer, Secretary, and as chair and co-chair of various committees. Michael has and continues to serve with the PIABA Bar Journal, including stints as Editor (2011-2012), Managing Editor (2013), Editor in Chief (2014-2015), and Advisor (2016 to present). He also authored and/or co-authored several articles and other materials for the Bar Journal and other publications.

Michael is a 1994 graduate of Whittier College, with B.A.s in both Business Administration and Economics. In 1997, he obtained his J.D. from Pepperdine University School of Law, and was admitted to the California Bar later that same year. He received his Master's Degree in Dispute Resolution from Pepperdine in 2001.

Samuel B. Edwards, Esq.
Shepherd, Smith, Edwards & Kantas, LLP
Houston, Texas

Sam Edwards is a partner in the Houston based firm of Shepherd, Smith, Edwards & Kantas. Sam and his firm focus exclusively on representing investors in securities arbitration and litigation, all across the country. Sam and his firm have represented thousands of investors in cases involving basic unsuitability, fraud, complex product failures, firm trading flaws and many other issues. Sam is a member of the PIABA Board of Directors and past Editor-in-Chief of the PIABA Bar Journal. Sam is also a member of FINRA's National Arbitration and Mediation Committee, where he works with other PIABA members as well as defense lawyers to level the playing field for FINRA arbitration.

Steve Feaga, Esq.
Alabama Securities Commission

Steve Feaga is Deputy Director of the Alabama Securities Commission. He served as chief of the Criminal Division in the U.S. Attorney's Office for the Middle District of Alabama. Steve has more than two decades of experience in the office of the U.S. Attorney for the Middle District of Alabama, serving as both first assistant U.S. attorney and chief of the Criminal Division. He litigated and supervised criminal litigation on behalf of the federal government involving violations of federal fraud statutes including securities, banking, insurance, and public corruption. During his tenure, the FBI recognized Steve with multiple honors for excellence for prosecuting some of Alabama's most high-profile and complex criminal fraud and public corruption cases.

As deputy director of enforcement and litigation at the Alabama Securities Commission, Steve supervises a team of 25 attorneys, investigators and support staff in the investigation, regulation, prosecution and trial of securities fraud cases across the state of Alabama. He has also served as a special assistant U.S. attorney, as a deputy attorney general for the State of Alabama, as chief of the Special Investigations and Litigation Division, and as an assistant district attorney in the Montgomery County District Attorney's Office, where he was responsible for the prosecution of securities fraud, extortion, theft, ethics law violations, and other crimes.

Steve served for 30 years as a judge advocate, retiring as a full colonel, in the U.S. Air Force Reserve, advising commanders on a wide range of matters including military justice, inspector general and personnel matters. Steve earned his J.D. from Cumberland School of Law.

John T. Foster
Bedford & Main Financial Consulting, Inc.
Collingswood, New Jersey

John Foster is the founder and CEO of a specialized consulting firm, Bedford and Main Financial Consulting. His firm focuses on three areas: active consulting engagements, broker-dealer anti-money laundering and expert witness services.

His career spans over 35 years of senior management positions in the broker-dealer industry. He has a deep familiarity of the fundamentals, best practices, clearing services and the operational infrastructure of the industry. In the summer of 2012, John incorporated Bedford and Main Financial Consulting, Inc. He was certified as an Anti-Money Laundering Specialist (ACAMS) in 2016 and began providing annual AML independent testing to broker dealers, as required by FINRA Rule 3310. This quickly blossomed and now John services a robust and diverse book of broker dealer entities. He leveraged the annual test to also provide broker-dealers with consulting support, assisting firms to implement proper AML compliance programs and develop their written supervisory procedures.

John frequently serves as an industry expert witness on compliance and operational issues at FINRA arbitrations and civil cases, including Anti-Money Laundering issues. He is a certified FINRA Dispute Resolution Arbitrator and has passed the Series 3, 7, 24, 27 & 63. Bedford and Main Financial is listed in the FINRA Compliance Vendor Directory.

Frank Fox, Esq.
Alabama Securities Commission
Montgomery, Alabama

Frank Fox has practiced law for 36 years since earning his law degree from Stanford Law School. After forming the San Diego firm of Majors & Fox in 1992, he served as lead litigation counsel throughout the Southwest for several Fortune 500 companies in over 100 business litigation matters. He and his firm moved to the other side of the "v." around the turn of the century and began representing vulnerable consumers victimized by predatory payday lenders, proprietary vocational schools, rent-to-own companies, understaffed nursing homes, a so-called "military friendly" lender, dishonest financial advisors and unscrupulous insurance agents.

Mr. Fox's work in this area has recovered more than $100M for financially-abused elders and other vulnerable consumers, has generated more than $25M in *cy pres* funds which continue to benefit California consumers and is reflected in reported cases like *Brack v. Omni Loan Company, Ltd.* (2008) 164 Cal.App.4th 1312, *Shuts v. Covenant Holdco LLC* (2012) 208 Cal.App.4th 609 and *Mahan v. Charles W. Chan Ins. Agency, Inc.* (2017) 14 Cal.App.5th 841. In April of 2019, a Butte County California jury awarded Mr. Fox's 81-year-old client $4.3M against an insurance company and its agent who had used a "trust mill" to sell an unsuitable annuity causing a $19,000.00 economic loss.

Mr. Fox is a graduate of the Trial Lawyers College and is a frequent speaker on the subject of elder financial abuse at CLE and other conferences. He has provided training on elder financial abuse, *pro bono publico*, to judges, attorneys and Adult Protective Service workers. His work has been recognized by the California Consumer Federation, which gave him its "Consumer Champion" award, the Consumer Attorneys of California, which nominated him as "Streetfighter of the Year" and California Advocates for Nursing Home Reform, which honored him with its "William F. Taylor Memorial Award" in recognition of his efforts in "promoting justice for elder financial abuse victims."

Richard S. Frankowski, Esq.
The Frankowski Firm, LLC
Birmingham, Alabama

Richard S. Frankowski is the founder of The Frankowski Firm, and has represented hundreds of investors around the country in FINRA arbitrations and in civil litigation. His practice focuses on stock broker fraud, consumer class actions and direct and derivative shareholder litigation. Currently, Richard serves on the Board of Directors for the PIABA (Public Investors Arbitration Bar Association) Foundation, a 501(c)(3) public charity with a core mission of educating investors to prevent investment abuse and level the playing field for investors in FINRA arbitration.

Richard is the co-author of two books on investing and securities arbitration. The Practitioner’s Guide to Securities Arbitration helps lawyers to identify, evaluate, and pursue legal claims brought by investors against securities brokerage firms. It is intended to serve as a nutshell for securities litigation practitioners. This book is also used as a textbook in law school securities clinics around the country. Richard also co-authored The Investors’ Guide to Protecting Your Financial Future. It is his hope that investors will use the book to help them avoid financial abuses before they occur. It should also help investors better understand the securities arbitration process once negligent or fraudulent conduct has already resulted in a financial loss.

Richard is also a founding member of Maycomb Wealth Advisors, a fixed fee Registered Investment Advisor based in Incline Village, Nevada.

Adam Gana, Esq.
Gana Weinstein LLP
New York City, New York

Adam Gana is the managing partner of Gana Weinstein LLP. His practice focuses on all aspects of securities arbitration, complex commercial and business litigation. As a seasoned trial lawyer, Mr. Gana's experience includes litigation in both State and Federal Courts as well as in various alternative dispute resolution venues. As lead counsel, he has tried more than forty cases to verdict before the state and federal trial and appellate courts, AAA, JAMS, NFA and FINRA and has settled hundreds more cases through mediation and direct negotiation.

Mr. Gana was named in the New York *Super Lawyers Rising Stars*® for eight straight years (an honor given to the top 5% of attorneys), ranked AV® Preeminent™ by Martindale - Hubbell™ (the highest honor offered), and ranked by the National Trial Lawyers as one of the Top 100 attorneys in the state of New York.

Craig A. Gargotta, Esq.
United States Bankruptcy Judge
Western District of Texas, San Antonio Division
San Antonio, Texas

EDUCATION

B.A., History, Texas A&M University - 1981
M.A., History, Texas A&M University - 1984
J.D., St. Mary's School of Law - 1989

PROFESSIONAL ACTIVITIES AND HONORS

United States Bankruptcy Judge, October 1, 2007 – present
Adjunct Professor of Legal Writing, St. Mary's School of Law, 2002-2006, 2013 – present
Assistant U.S. Attorney, San Antonio, Texas, 1990-2007
Law Clerk to United States Bankruptcy Judge Ronald B. King, Western District of Texas, 1989-1990
Fellow, Foundation of the Federal Bar Association
Member, National Conference of Bankruptcy Judges
Master, Larry E. Kelly Inns of Court (Austin and San Antonio)
Board Member, Texas Aggie Bar Association
Member, Law Review Advisory Board, ABI Law Review, 2010-present
Member, Editorial Advisory Board, The American Bankruptcy Law Journal, 2020-2022
Past-Chair, FBA Bankruptcy Law Section
Council member and VP of Professional Education, Bankruptcy Section, State Bar of Texas 2013-2016
Editor-in-Chief, The Federal Lawyer, 2003-2008
Contributing Editor, American Bankruptcy Institute Journal, 1993-2007
Contributing Editor, The San Antonio Lawyer, 1997-2001
President, San Antonio Chapter of the Federal Bar Association, 1996-1998

LAW RELATED PUBLICATIONS

Speaker - Bankruptcy seminars with the State Bar of Texas, University of Texas Law School, Federal Bar Association, National Conference of Bankruptcy Judges, and San Antonio Bankruptcy Bar.

I have written 24 columns for the ABI Journal; published a law review article in the American Bankruptcy Institute Law Review in 2003; and published roughly 25 columns or articles in other publications such as The San Antonio Lawyer, The Federal Lawyer, In Bankruptcy (a DOJ publication), and the United States Attorneys Bulletin.

COMMUNITY SERVICE

Boy Scouts of America, 2000 – 2015
United Methodist Church, Sunday School Teacher, 1998 – 2006

Robert J. Girard, II, Esq.
Girard Bengali, APC
Los Angeles, California

A founding partner of Girard Bengali, APC, Robert J. Girard II advocates for institutional and individual investors in arbitration and litigation against unscrupulous brokerage and advisory firms in both court and FINRA Dispute Resolution/Arbitration. For 20 years, he has built a reputation as an effective advocate for his clients and has recovered millions of dollars for investors from most of the major Wall Street brokerage firms. Through negotiated settlements, arbitrations and trials, Mr. Girard has a proven track record of successfully protecting his clients' interests with a results-oriented approach and a zealous commitment to meeting, and exceeding, his clients' expectations. Mr. Girard's representations include victims of financial elder abuse, securities fraud, breach of fiduciary duty, unsuitable investment strategies, misrepresentations, account mismanagement, among others. Mr.

Girard also represents securities professionals in employment disputes against broker-dealers and advisory firms, including claims for wrongful discharge, unfair business practices, retaliation, discrimination and Form U5 defamation claims.

From 2015 through 2020, Mr. Girard was named to the Southern California *Super Lawyers* list, and for three consecutive years (2012-2014) he was selected to the Southern California *Rising Stars* list by Super Lawyers Magazine, a designation earned by less than 2.5% of attorneys under the age of forty.

Glenn S. Gitomer, Esq.
McCausland, Keen & Buckman
Devon, Pennsylvania

Mr. Gitomer is a shareholder of McCausland Keen + Buckman in Devon, Pennsylvania and chairs the firm's Litigation Department. eHe has been involved in all aspects of complex business litigation since 1980. His practice focuses in the areas of securities litigation and arbitration, commercial and complex civil litigation, and employment litigation. In 2008, he was honored by Pennsylvania Super Lawyers in the area of Business Litigation, and, from 2009 through 2020, he was honored by Pennsylvania Super Lawyers in the area of Securities Litigation. He is "av" rated by Martindale-Hubbell.

Mr. Gitomer's securities litigation and arbitration practice involves the representation of customers in investment disputes. He was a member of PIABA's board of directors and Co-Chair of the Annual Meeting Committee. From 2011 through 2016, he served on FINRA's National Arbitration and Mediation Committee ("NAMC"), where he chaired the NAMC's Neutral Roster Subcommittee and Rules and Procedures Subcommittee. From 2016 through 2019, he served as Chairman of FINRA's Discovery Task Force.

Mr. Gitomer has authored numerous articles and has frequently lectured on issues relating to securities claims and arbitration. He was the course planner for the Pennsylvania Bar Institute's "Prosecuting and Defending Customer Claims Against Stockbrokers" (1999, 2001, 2003, 2005) and "Recent Developments in Securities Arbitration" (2009) programs, and was a speaker at the 2004, 2009, 2010, 2012, 2013, 2014 and 2016 PIABA Annual Meetings and the Practicing Law Institute's Securities Arbitration 2002 and 2017 programs.

Mr. Gitomer received a B.F.A. from New York University in 1971, and a J.D. from the Robert H. McKinney School of Law (Indiana University) in 1974. He was admitted to practice in Pennsylvania in 1974, Florida in 1980, and New York in 2004. From 1974 through 1979, he was an assistant district attorney in Philadelphia, PA.

Sara E. Hanley, Esq.
Hanley Law
Naples, Florida

Sara Hanley focuses her practice on representing investors nationwide who have lost their savings and retirement funds as a result of their brokerage accounts being mishandled. Attorney Hanley is the founder of Hanley Law which focuses exclusively on representing investors in claims against their brokers, broker dealers, investment advisors, financial advisors and insurance companies. Ms. Hanley is experienced in providing representation for investors who have been the victims of financial fraud, negligence and unsuitable investments. Attorney Hanley has experience in prosecuting claims against the major Wall Street brokerage firms.

Ms. Hanley has litigated several national securities related class action lawsuits. Recently, Ms. Hanley represented a group of foreign investors in an action against Raymond James which arose from the mismanagement and transfer of funds and margin loans among accounts resulting in a class action settlement of $150 million dollars. Ms. Hanley represented class members in the United States District Court Southern District of Florida in a class action against Newbridge Securities which resulted in a substantial settlement. Ms. Hanley also represented national class members in securities class action litigation against Raymond James before the United States District Court Southern District of Florida which resulted in a $15 million dollar class action settlement. Ms. Hanley has represented thousands of investors in securities arbitration and litigation. Attorney Hanley is duly licensed to practice law in both Florida and North Carolina and represents clients in FINRA arbitrations nationwide.

Ms. Hanley graduated with honors from the University of North Carolina Chapel Hill and attended law school at Nova Southeastern University where she received an academic scholarship and graduated Magna Cum Laude. Ms. Hanley is a member of the Public Investors Arbitration Bar Association ("PIABA") where she serves as the 2020 Editor-in-

Chief of the national PIABA Bar Journal. Ms. Hanley also serves as an arbitrator for the Financial Industry Regulatory Authority ("FINRA"). Ms. Hanley is admitted to practice before the United States District Court for the Southern and Middle Districts of Florida and the United States District Court of Appeals for the Eleventh Circuit. Attorney Hanley has been featured in various publications including Bloomberg Business, Financial and Economic News, Investment News, Lawyers Weekly and various law journals. Throughout her legal career Ms. Hanley has dedicated numerous hours to the community by working on both political campaigns, as well as, providing legal services to non-profit organizations.

Angela D. Hayden, Esq.
Sage Legal, LLC
Newmarket, New Hampshire

Angela is a long-time member of PIABA (excluding her two year stint in the world of commercial insurance working with ski areas). She initiated her own life re-boot, founding Sage Legal, LLC, a law practice in Newmarket, NH, combining her years of experience in Boston's Financial District with her insurance knowledge and a deep desire to align her life, commute, and businesses with the dreams she carried around in the back of her mind for way too many years.

She loves settling cases, writing compelling demand letters, having meaningful conversations with clients, and inspiring other lawyers to create their own simplified lives that give them more of what they want and less of what they don't.

Brian Henderson
Securities Litigation and Consulting Group, Inc.
McLean, Virginia

Dr. Henderson is Associate Professor of Finance at The George Washington University where he teaches investment analysis and portfolio management, performance evaluation, derivatives, and fixed income. He is a Chartered Financial Analyst. He has presented his research at academic conferences, universities, and market regulators. He publishes extensively in elite peer-reviewed journals and professional books.

Dr. Henderson is as expert in damages computation, derivatives, portfolio management, investment performance evaluation, structured products, fixed income, and investment companies. He has testified in FINA arbitrations as well as both state and federal courts.

His investment management experience includes retirement plan design, investment performance evaluation, portfolio design, and quantitative investment research. He has also been on the investment committee at a tactical ETF portfolio manager and worked in the Asset-Backed Securities Practice at PricewaterhouseCoopers LLP.

Ross B. Intelisano, Esq.
Rich, Intelisano & Katz, LLP
New York City, New York

Ross B. Intelisano is a founding partner of Rich, Intelisano & Katz, LLP in New York. He represents individual and institutional investors in securities arbitration and litigation against financial firms, employees in industry disputes, employees in transitions from one financial firm to another, and employees in self-regulatory organization investigations.

Ross has over two decades of experience trying large and complex financial fraud cases on behalf of investors worldwide. He and his team won the largest arbitration award ever against Goldman Sachs ($21 million) and a $43 million arbitration award against Refco (collected pre-bankruptcy). Both awards were for over 100% of the customers' losses. His clients include high net worth individuals, family offices, hedge funds, funds of funds, endowments, non-profits and other institutions in claims against brokerage firms, investment and private banks, investment advisors, hedge funds and other financial companies. Ross is a leading authority on securities and financial fraud and is a frequent television and print commentator.

Within the Wall Street employment sphere, Ross has represented CEO's and other C-Suite executives, traders, salespersons, investment bankers, hedge fund and private equity executives, and scores of high end financial advisors and large broker teams in transitions amongst firms, disputes with employers and partners, and issues with regulators.

Alise Johnson, Esq.
Senior Trial Counsel
U.S. Securities & Exchange Commission
Miami, Florida

Experienced Advisor with a demonstrated history of working in the law and regulatory industry. Skilled in Regulatory practices, Arbitration, Trial Practice, Dispute Resolution, Securities, and fundraising for non-profits. Strong professional with a JD from University of Florida and a BA from Vanderbilt University.

Jason Kane, Esq.
Peiffer Wolf Carr & Kane, APLC
Pittsford, New York

Jason graduated from the State University of New York at Geneseo, in 2004, with a B.A. in Economics. Jason attended the Syracuse University College of Law, and received his Juris Doctorate, *cum laude*, in 2007. Following law school, Jason began his career working in the Legal Department of Wegmans Food Markets, Inc., one of Upstate New York's largest employers. At Wegmans, Jason worked with the finance, real estate and human resources departments, as well as outside counsel.

Since 2009, Jason has focused his practice on securities law. Jason has represented hundreds of investors in Upstate New York and around the country in some of the highest profile securities cases originating out of Upstate New York. He has recovered millions of dollars in FINRA arbitrations and mediations while representing individuals against their former brokers and brokerage firms. He often assists his victimized clients through the regulatory investigations that result from large-scale scams perpetrated by their brokers.

Ronald B. King, Esq.
Chief United States Bankruptcy Judge
Western District of Texas
San Antonio, Texas

EDUCATION:
1974: Bachelor of Arts in Political Science with High Honors, Southern Methodist University

1977: Juris Doctor with High Honors, the University of Texas School of Law

EMPLOYMENT AND PROFESSIONAL ACTIVITIES:
1977 -- 1978: Briefing Attorney, Supreme Court of Texas (Justice James G. Denton)

1978 -- 1982: Associate, Foster, Lewis, Langley, Gardner & Banack, Incorporated,
San Antonio, Texas

1982 -- 1988: Shareholder, Foster, Lewis, Langley, Gardner & Banack, Incorporated,
San Antonio, Texas

1988 -- Present: United States Bankruptcy Judge, Western District of Texas

2006 -- Present: Chief United States Bankruptcy Judge, Western District of Texas

2014 -- 2016: Founding President, The Honorable Larry E. Kelly BankruptcyAmerican Inn of Court

Member: San Antonio Federal Bar Association (board member); San Antonio Bar Association; San Antonio Bankruptcy Bar Association; National Conference of Bankruptcy Judges (Fifth Circuit Governor); Bankruptcy Judges Advisory Group

HONORS: Phi Beta Kappa; Order of the Coif; Phi Delta Phi; Life Member, Texas Parent Teacher Association

Marnie C. Lambert, Esq.
Lambert Law Firm, LLC
Columbus, Ohio

Marnie C. Lambert is a 1992 graduate of the Pepperdine University School of Law in Malibu, California. She has spent the past 15 years representing investors across the country in securities disputes with firms and representatives licensed by FINRA, the SEC and various states' securities divisions. She has represented investors in arbitration cases processed by FINRA, JAMS and AAA, as well as in court cases on a state and federal level.

Ms. Lambert has been an active member of the Public Investors Advocate Bar Association ("PIABA") since 2005, serving on the Board of Directors for the past 8 years (as Treasurer, Executive VP/President Elect and President from 2014-2017). She has participated in several panels over the years at PIABA Annual Meetings and she was panelist at the Practising Law Institute's Securities Arbitration Programs in New York City in 2017 and 2018. She has been an appointee to the Ohio State Bar Association ("OSBA") Annual LGBTQ (and Allies) Diversity and Inclusion Conference Planning Committee since 2011 (serving as Co-Chair in 2016) and she was an appointee to the OSBA's Litigation Section Council from 2005-2012.

Ms. Lambert has a reputation for her no-nonsense approach to cases and she is well-respected by clients, co-counsel, opposing counsel, arbitrators, mediators, and judges alike. She is licensed to practice law in the states of Ohio and California and in all United States District Courts in Ohio and California.

Alexander N. Loftus, Esq.
Stoltmann Law Offices
Barrington, Illinois

Alexander Loftus is Of Counsel with Stoltmann Law Offices and principal of Loftus & Eisenberg, Ltd. and has resolved a wide range of significant cases through mediation, arbitration, and trial across all sectors of commercial litigation, including breach of contract, fraud, professional malpractice, business divorce, and shareholder disputes. Alex specializes in litigating business, commercial, and class action cases and is passionate about fighting for the little guy. His practice has focused on insurance coverage issues involving brokerdealers, attorneys, accountants, home insurers, and more recently business interruption claims.

Alexander is admitted to practice in Illinois State Courts, Northern District of Illinois, Eastern and Western District of Wisconsin, Northern District of Texas, Federal Trial Bar, and The Seventh and Eleventh Circuit Courts of Appeals. He is also currently admitted pro hac vice in case pending in Wisconsin, Minnesota, Florida, and California.

Alexander is a member of the Illinois State Bar Association, Illinois Trial Lawyer's Association. From 2013-2020, Alexander has been designated a Rising Star by Law and Politics and the publishers of the Chicago Magazine, which is a decoration given to only 2.5% of attorneys in the State of Illinois. In 2013 Alexander was esteemed "Superb" by AVVO which is an unbiased physician and attorney rating agency and was designated in the Top 100 Trial Lawyers by the National Trial Lawyers Association.

Jenice L. Malecki, Esq.
Malecki Law
New York, New York

Jenice L. Malecki, Esq. is a well-known New York securities attorney and has been a FINRA arbitrator and Chairperson. She represents individual and institutional investors in arbitration and litigation, as well as licensed industry participants in regulatory hearings, employment disputes and whistleblower matters. She has represented private and public companies around the world, as well as individuals, from blue-collar workers to athletes, musicians, and billionaire founders of well-known international companies. Malecki Law has represented clients in the United States, many Western European countries, India, China, Hong Kong, Singapore, Israel, Puerto Rico and in several South American countries.

Ms. Malecki has been a member of FINRA's National Arbitration and Mediation Committee, on the Board of Directors (and an Officer of) of both the Public Investors Arbitration Bar Association (PIABA) and the PIABA Foundation, as well as has been a member of the Securities and Exchanges Committee at the New York City Bar Association, as well as has been a member of the American and New York State Bar Associations. She has spoken at the Practicing Law Institute (PLI), the New York City Bar Association and the New York County Lawyers Association on several panels, and at Fordham Law School, St. John's Law School, Brooklyn Law School and New York Law School, in

addition to speaking at PIABA's annual conferences. Ms. Malecki has also participated in mock trials at Yale, Columbia, Albany, Fordham and FINRA.

Jenice L. Malecki's experience as a New York securities attorney began in class action litigation, In re Crazy Eddie, counsel's office of the lead plaintiffs. Throughout the 1990s she represented numerous broker dealers and was instrumental in regulatory matters against well-known "boiler room" stock fraud of the era, including working with people and firms associated with the notorious "Wolf of Wall Street." In 1999 Ms. Malecki founded her own practice, MALECKI LAW, in Manhattan.

Since 2012, Ms. Malecki has been named a Top Attorney by Super Lawyers and the National Law Journal, featured in the New York Times Magazine, New York Magazine, National Law Journal and other publications, as well as being named as one of "New York's Women Leaders in the Law 2014." Ms. Malecki is Martindale-Hubbell's highest legal ability rating of "AV Preeminent." She appears regularly on TV, in the news and on the radio. She is a frequent bar association and law school speaker, as well as a seasoned authority on New York law, who frequently files official comments for consideration on new rules and laws. In 2014, 2015 and 2019, she visited Senators and House of Representatives members' offices to garner support for investor related laws.

Thomas Mauriello, Esq.
Mauriello Law Firm, APC
San Diego, California

Tom Mauriello founded the Mauriello Law Firm, APC in 1996 after working at a large national plaintiffs' securities class action form and several small firms. Tom focuses on investment and consumer disputes, with customer FINRA arbitrations constituting a large part of his practice. He also handles business litigation, consumer class actions, and appeals.

Tom is a member of the California, New Jersey and Pennsylvania bars. He received his BA from Brown University in 1983 and JD from the University of San Diego School of Law in 1988. Prior to law school, he worked as a paralegal in New York City for a law firm registering securities offerings with the SEC and state securities agencies. Following law school, Tom served as a judicial clerk to Judge Robert E. Cowen of the U.S. Court of Appeals for the Third Circuit.

Tom serves on the Administration of Justice Committee and the Mandatory Fee Arbitration Committee (as an attorney-client fee arbitrator) with the Orange County Bar Association. He also serves on the PIABA Legislation Committee and participated in PIABA's "Hill Day" in March 2016. From 2012 through 2015, Tom served as Co-Chair of the Legal Committee of the Angeles Chapter of the Sierra Club.

When he is not working, Tom enjoys spending time with his 17-year old daughter, surfing, wine tasting, fitness boot camp, traveling, and playing keyboards in several rock bands.

Laura McNamire, Esq.
Regional Director
FINRA Dispute Resolution
Los Angeles, California

Laura D. McNamire is the Western Regional Director for FINRA Dispute Resolution Services.

Ms. McNamire joined the Los Angeles office of FINRA, then NASD, in 2002 as a Staff Attorney. In 2009, she was promoted to Regional Director. Ms. McNamire also serves as a member of FINRA's Diversity Leadership Council, supporting a culture of inclusion and diversity awareness.

Ms. McNamire was a member of the Pepperdine/Straus American Inn of Court from 2018 to 2019, and taught arbitration courses at Pepperdine University's Straus Institute for Dispute Resolution in 2016. She was also an adjunct professor at Woodbury University from 2007 to 2012, where she taught masters level courses in business ethics and conflict resolution.

Prior to joining FINRA, Ms. McNamire specialized in general litigation and worked with a sole practitioner in Los Angeles. She is a graduate of Pepperdine University School of Law (J.D.), Southern Methodist University (M.A., Applied Economics), and The University of Texas (B.A., Economics). She is a member of the California Bar.

David P. Meyer, Esq.
Meyer Wilson Co., LPA
Columbus, Ohio

David P. Meyer is the managing principal of Meyer Wilson, a national law firm with offices in Ohio, Michigan and California.

Since starting the law firm in 1999, David has earned a national reputation for successfully representing investors who are victims of investment fraud. He has represented more than 1,000 individual investors from all across the country in securities arbitration and litigation. Meyer Wilson has also been appointed lead and co-lead counsel in numerous consumer class actions across the country. The firm also represents hundreds of clients who suffered serious injuries from dangerous drugs and defective medical devices. His firm has recovered more than $350,000,000 for its clients.

David is currently President-Elect of the Public Investors Advocate Bar Association (PIABA), a national association of lawyers who represent individual investors in cases of investment fraud. He is also President-Elect of the Ohio Association of Justice, the statewide bar of trial lawyers in the state of Ohio.

David Miller, Esq.
Shepherd, Smith, Edwards & Kantas, LLP
Houston, Texas

David Miller is an associate attorney at Shepherd, Smith, Edwards, and Kantas, LLP, one of the top securities law firm in the U.S. focused exclusively on the protecting investor's rights and recovering investment losses. For more than five years, Mr. Miller has successfully represented individual and institutional investors, corporate executives, business owners, regional banks, and municipal issuers in securities-related misconduct and investment fraud matters committed by financial institutions and brokers.

Mr. Miller's career began in the financial services industry, where he served as an officer in various corporate trust and investment banking groups at major financial institutions. In these roles, he gained extensive expertise and experience with exotic financial products while acting as an indenture trustee for collateralized debt obligations (CDOs) and mortgage backed securities. Mr. Miller also gained exposure to complex derivative contracts while working with a major oil and gas corporation. In those roles, Mr. Miller gained a unique and highly valuable perspective on dealing with complex products, which has been invaluable to Mr. Miller's clients, tilting the scales in their favor time and time again to maximize their case values and to secure successful outcomes to their claims.

In his free time, he enjoys spending time with his wife and two young children.

Luis Minana, Esq.
Espada Minana & Pedrosa Law Offices, PSC
San Juan, Puerto Rico

Practice areas: Inheritance; Probate; Tax law; Family law; Consumer law; Securities; Commercial litigation; Torts

Admitted: Puerto Rico, 2006; U.S. Court of Appeals, 1st Circuit, U.S. District Court, 2007

Education: Rensselaer Polytechnic Institute; Inter-American University MBA Studies Economics;
District of Puerto Rico Law School; Inter-American University of Puerto Rico, J.D.

Languages: English; Spanish

Associations and memberships: Puerto Rico Bar Association; Public Investors Arbitration Bar Association (PIABA)

Biographical details: Recipient, Economics Medal, Inter-American University; Precious and Semi-Precious Stones Certified, Gemological Institute of America Diamonds; First Vice President, Financial Planning Specialist, Citibank/Citigroup Global Markets, Smith Barney, San Juan, Puerto Rico, March 1990-October 2006; Financial Planning Specialist, Gemological Institute of America Precious Stones and Diamonds Certified Expert Witness in Securities; Vice President and Senior Account Executive, Kidder Peabody & Co. (General Electric), San Juan, Puerto Rico, May 1984– March 1989; Treasurer, YMCA

Kalju Nekvasil Esq.
Goodman & Nekvasil, P.A.
St. Petersburg, Florida

Kalju Nekvasil is admitted to the state bars of Florida and Louisiana, several federal district bars, as well as the federal bars in the Second, Sixth, and Eighth Circuit Courts of Appeal. A graduate of Duke University Law School at age 21, Mr. Nekvasil has more than thirty years of legal experience, including seven years as Regional General Counsel for the NASD in New Orleans. As NASD Regional General Counsel, Mr. Nekvasil prosecuted hundreds of cases against stockbrokers for violations of securities laws and industry rules. Mr. Nekvasil has served as a lecturer at arbitrator training seminars for the NASD and been quoted in publications such as the Wall Street Journal.

William D. Nelson, Esq.
Lewis Roca Rothgerber Christie
Colorado Springs, Colorado

William D. Nelson is a partner in the firm's Securities Litigation practice group and a member of the Data Protection and Cybersecurity team. His practice is concentrated in the area of securities litigation, securities arbitration and regulatory defense. Bill represents broker-dealers, registered investment advisors and individual securities professionals. Bill has been involved in more than four hundred arbitration proceedings, as counsel and as an arbitrator, before FINRA, NASD and AAA. Bill has represented clients in injunctive cases in various courts involving non-competition and non-solicitation agreements. He has represented clients in investigation and enforcement actions before the SEC, FINRA and various state regulators. Bill also represents businesses and employers in employment matters including defending and enforcing restrictive covenants, wrongful termination issues, discrimination issues and handling matters before the EEOC and its state counterparts.

Bill spent six years as Associate General Counsel to a New York Stock Exchange member firm where he had both legal and business responsibilities.He held various securities licenses including registered representative, general securities principal and branch office manager. Bill has also acted as an expert witness in securities arbitration matters.

David P. Neuman, Esq.
Israels & Neuman, PLC
Seattle, WA 98104

David Neuman is an attorney who has been representing the interests of investors and consumers for over a decade. Before co-founding Israels & Neuman in the Summer of 2014, Mr. Neuman worked for over seven years at a law firm in Chicago which focused its practice on representing aggrieved and defrauded investors, mostly in FINRA arbitration. Throughout his years of experience, Mr. Neuman has recovered millions of dollars in hundreds of FINRA and court cases, on behalf of clients from over 40 states, as well as investors from the international community. In addition to representing investors in FINRA Arbitration, Mr. Neuman has represented investors in numerous courts throughout the U.S., as well as represented persons deceived by their insurance brokers and parties in shareholder disputes.

Mr. Neuman is currently on the Board of Directors of PIABA. He is currently the co-chair of the Membership Committee and has chaired several other committees. He is also an arbitrator with FINRA Dispute Resolution. David Neuman is admitted to practice law in Illinois, Washington, and Florida, as well as several federal courts.

Mr. Neuman graduated with Honors from the University of Illinois in December 2001 with a B.S. in Finance. He attended the Northern Illinois University College of Law and graduated Magna Cum Laude in May 2005. While at the NIU College of Law, Mr. Neuman was on Law Review and was an Associate Justice for the Moot Court Society. In addition, during his time at the NIU College of Law, he also was a research assistant for Professor David Gaebler and researched various areas of contract, commercial, and consumer law.

Darlene Pasieczny, Esq.
Samuels Yoelin Kantor LLP
Portland, Oregon

Darlene Pasieczny (pronounced "Pah-shetch-nee") is a securities and fiduciary litigator, and leads the Investor Defenders practice group at Samuels Yoelin Kantor LLP, based in Portland, Oregon. Darlene works all stages of securities litigation and FINRA arbitration, fiduciary litigation in trust and estate disputes, elder financial abuse,

complex civil litigation, and related appeals. She represents investors nationwide to recover investment losses caused by financial advisor misconduct or defective securities products. Previously, Darlene worked at Banks Law Office PC, where she developed her concentration on securities litigation and FINRA arbitration.

Darlene serves on the Board of Directors of the Public Investors Arbitration Bar Association (PIABA) and is a frequent speaker on FINRA arbitration, trust and estate matters, and elder financial abuse prevention, recognition, and recovery. Other professional affiliations include the Oregon State Bar, Washington State Bar, U.S. District Court for the State of Oregon, Multnomah Bar Association, and the Gus J. Solomon American Inn of Court. Darlene earned a B.A. from Reed College, *Phi Beta Kappa*, an M.A. from Columbia University, and J.D. from Lewis and Clark Law School, *magna cum laude*. www.InvestorDefenders.com

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Joseph C. Peiffer, Esq.
Peiffer Wolf Carr Kane & Conway, APLC
New Orleans, Louisiana

Joe is the Managing Shareholder of Peiffer Wolf Carr Kane & Conway, APLC. Based in the firm's New Orleans office, Joe has a wide-ranging practice focusing on cases that change lives. His practice consists of representing families affected by IVF clinic malfeasance, representing individuals and institutions that have been harmed by investment banks and brokerage firms, prosecuting ERISA class actions, and representing victims of labor trafficking, unscrupulous drug companies and those who have suffered catastrophic injury.

In his financial services practice, Joe has represented hundreds of individual retirees against their brokers in FINRA arbitration. The highlights of this practice include representing 32 Exxon retirees in a 90-day FINRA arbitration against Securities America that resulted in a $22 million verdict – one of the largest ever awarded by a FINRA arbitration panel. He has also represented hundreds of Xerox and Kodak retirees against their brokers resulting from the brokers' fraudulent advice to retire and subsequent unsuitable investments. He has represented hundreds of families in cases involving private placements and Ponzi schemes.

His financial services fraud practice included representing approximately 25 municipalities and hospitals around the country in cases involving their issuance of auction rate securities. He also has litigated several ERISA class actions against large financial services firms regarding their imprudent investments of retirement money and conflicts of interest.

Julie B. Porter, Esq.
Salvatore Prescott Porter & Porter
Evanston, Illinois

A calm, confident leader, Julie Porter excels at solving complex legal problems for her clients. Julie is a careful investigator, a skilled negotiator, and an exceptional trial lawyer who is a Fellow in the American College of Trial Lawyers. She has committed her career to seeking justice and becoming a voice for those who might not otherwise be heard. At Salvatore Prescott Porter & Porter, PLLC, Julie brings her deep experience with complex commercial litigation and prosecuting public corruption, financial crimes, and child exploitation to a private practice that focuses on sophisticated criminal defense and investigative work, commercial litigation, and civil rights and employment litigation.

After graduating with honors from Williams College and The University of Michigan Law School, Julie joined the litigation department at Kirkland & Ellis LLP. As a partner in Kirkland's Chicago office, Julie represented clients as both plaintiffs and defendants, in commercial and employment cases big and small.

Julie then served the public as an Assistant United States Attorney in Chicago, handling some of the most significant cases that the U.S. Attorney's Office has brought over the past decade. Julie successfully tried to juries complex cases that garnered nationwide interest, including cases against international media baron Conrad Black (corporate fraud), Illinois powerbroker Bill Cellini (public corruption), top Chicago Mayoral aide Robert Sorich (public corruption), and prominent Jesuit priest Donald McGuire (child exploitation), among others. As Chief of the Chicago Office's Criminal Division, Julie supervised nearly 150 criminal prosecutors and all criminal prosecutions, including health care fraud, securities and commodities fraud, other financial crimes, public corruption and organized crime, national security, cybercrimes, violent crimes, narcotics, and appeals. Julie mentored many AUSAs and promoted a culture of excellence at the U.S. Attorney's Office, which she carries into her practice at Salvatore Prescott Porter & Porter.

Finally, Julie is also an arbitrator, serving on the American Arbitration Association's national roster for commercial cases. One of Julie's greatest abilities as a lawyer is being a problem-solver. She avoids tangents, focuses on key issues and how to overcome obstacles, shows creativity in finding solutions to tough problems, and works well with

others. She is also experienced at facilitating collaboration among groups with differing interests in highly sensitive matters. For more information about Julie's availability to serve as an arbitrator on a commercial matter, please reach out to her directly or contact the American Arbitration Association at (312) 616-6560 .

Randall A. Pulman, Esq.
Pulman, Cappuccio & Pullen, LLP
San Antonio, Texas

Education & Training:
University of Texas Law School, J.D., 1986
Editorial Board of The Review of Litigation
Director of the Board of Advocates
University of Texas at Austin, B.B.A., 1983
Major: Finance

Practice Areas:
Bankruptcy
Business Litigation
Complex Commercial Litigation
Insurance Coverage Disputes
Securities Fraud & Broker-Dealer Disputes
Telecommunications & Regulatory Law
Real Estate Disputes

Professional Experience:
Mr. Pulman has been a member of the State Bar of Texas since November of 1986. In addition to being licensed in all Texas state courts, Mr. Pulman is licensed to practice in the United States District Courts for the Northern, Southern, Eastern and Western Districts of Texas, the United States Court of Federal Claims, the United States Fifth Circuit Court of Appeals, and the United States Supreme Court.

Mr. Pulman began practicing in Houston, Texas with Stumpf & Falgout, P.C., became a shareholder in 1992, and opened the firm=s branch office in San Antonio, Texas in 1994. The firm changed its name to Stumpf, Craddock, Massey & Pulman, P.C. in 2000.
Pulman, Cappuccio & Pullen, LLP was founded in 2004. Sixteen years later, the law firm has gained prominence in the Texas legal market.

Mr. Pulman has represented a wide range of commercial clients in the fields of banking and creditor rights, bankruptcy, telecommunications, broker/dealer, and insurance coverage disputes. Mr. Pulman has extensive courtroom and arbitration experience, including numerous jury trials, and has argued two cases before the Texas Supreme Court and three cases before the United States Fifth Circuit Court of Appeals.

Community Service:
State Bar of Texas, Member Pattern Jury Charge Committee
Chairman of the Board, Golden Manor Foundation
President, Vice-President and Treasurer, Congregation Agudas Achim
President, Congregation Agudas Achim Endowment Foundation
Board Member, Camp Young Judaea

Personal:
Mr. Pulman is a native of San Antonio, Texas, is married to his childhood sweetheart and has three adult children.

Brandon S. Reif, Esq.
Reif Law Group, P.C.
Los Angeles, California

Reif Law Group, P.C. is California's preeminent boutique trial and litigation law firm for securities and business disputes. Brandon S. Reif is a trial attorney with a track record of winning trial verdicts and arbitration awards.

Mr. Reif is Martindale-Hubbell® AV Preeminent™ peer-rated, Judicial Edition-rated, and a Client Champion Platinum™ client-rated attorney. He is one of Los Angeles Magazine's "Top Attorneys in Southern California" for 2011-2020 and Southern California's Super Lawyer® for 2011-2020 (elevated from Rising Stars® in 2015). He is "America's Most Honored Professionals – Top 1%" for 2016-2020. Mr. Reif received Top Verdict Magazine's Top 10

Court Verdicts in California for a commercial loan trial against a real estate broker. He earned Los Angeles Daily Journal's Top Verdict Award for a municipal bond fund jury trial. He is a frequent author, speaker and commentator for securities, professional liability and real estate topics.

Mr. Reif has won "run-away" trial and arbitration verdicts for plaintiffs-claimants and full defense verdicts plus attorneys' fees for defendants-respondents. Mr. Reif has delivered trial wins after taking over cases for other attorneys. He welcomes joint representations and referrals for trial and arbitration.

Mr. Reif represents the securities and financial services industries in actions, including customer, vendor, sponsor and insurer disputes. He has extensive experience handling financial elder abuse and complex securities-insurance matters, shareholder derivative actions and industry raiding and recruiting matters. He defends enforcement actions and investigations with governments and regulators.

Mr. Reif also has extensive experience litigating professional liability cases. He handles cases involving accountants and auditors, attorneys and law firms, architects and engineers, insurance agents, agencies and issuers and real estate agents, brokers, financiers, lenders and escrow officers in court, arbitration and administrative forums.

His employment experience focuses on workplace misconduct involving harassment, discrimination, retaliation, recruitment and Form U5, and business disruption and restraining order actions involving non-compete, non-solicit and confidentiality clauses.

Mr. Reif's contact information is 310.494.6500 and www.reiflawgroup.com.

Sander J. Ressler
Ressler Consulting Services
Delray Beach, Florida

Sander Ressler, Managing Director of Essential Edge Compliance Outsourcing Services, LLC, has broad and deep expertise in financial services compliance and operations – including more than 20 years of hands-on, frontline experience with broker-dealers and registered investment advisers. Sander began his career working for a regulator and subsequently served in senior compliance positions for financial services firms including American Express, American General Life Insurance, AIG, ING, and Société Générale S.A. He has led more than 20 regulatory examinations conducted by the SEC, FINRA and various state departments governing banking, securities, and insurance.

Since launching his own consulting company, Sander has assisted financial institutions with a wide range of outsourced compliance-related services, such as written supervisory procedures, branch office inspections, review and approval of advertising, and electronic correspondence.

Sander currently holds the Series 7, 24 and 63 securities licenses. He previously held the Series 3, 4, 8, 9, 14, 53 and 65 licenses.

James D. Sallah, Esq.
Sallah, Astarita & Cox
Boca Raton, Florida

Mr. Sallah is an AV Preeminent® rated attorney who concentrates his practice on securities and commodity futures regulation and enforcement matters, receiverships and receivership litigation, broker-dealer compliance and defense, whistleblower claims, and business litigation.

Since leaving the Securities and Exchange Commission in 2004, Mr. Sallah has represented national and regional brokerage firms, as well as publicly-traded companies and individuals, in a variety of matters, including investigations, administrative proceedings, and litigation involving the SEC, FINRA and state securities regulators. Mr. Sallah has also handled white collar criminal matters and represented individuals in U.S. congressional sub-committee hearings.

Mr. Sallah's reputation as a securities lawyer is well recognized among his peers. He has been selected as a *Florida Super Lawyer* in the area of Securities Litigation each year since 2011 and has been included among *Florida Trend's Legal Elite*. Moreover, Mr. Sallah has also been recognized in the *South Florida Legal Guide* each year since 2008 in the field of Securities Litigation and Arbitration. In 2009 the *Daily Business Review* selected Mr. Sallah as the "Most Effective Lawyer" in South Florida in the area of Securities Law. Mr. Sallah has also testified as an expert witness on securities matters in United States Bankruptcy Court, FINRA Arbitrations, Florida state Court, and before international

tribunals. Since 2012 he has served as an adjunct professor at the University of Miami School of Law, where he teaches a class in SEC enforcement and litigation.

Before entering private practice, Mr. Sallah was a Senior Counsel in the SEC's Division of Enforcement in Miami, Florida. During his tenure at the SEC, Mr. Sallah handled investigations and litigation in both federal court and administrative forums, including cases involving fraudulent securities offerings, Ponzi schemes, market manipulations, municipal bonds, research analyst conflicts, public company disclosure and periodic reports, and broker-dealer and investment adviser regulation.

Prior to joining the SEC, Mr. Sallah was Assistant Corporate Counsel for Raymond James Financial, Inc., the largest brokerage institution in the Southeastern United States. While at Raymond James, he represented its broker-dealer subsidiaries and their associated persons in a variety of matters, including litigation and arbitration.

Moshe Y. Singer, Esq.
Law Office of Moshe Y. Singer, LLP
Brooklyn, New York

Moshe Y. Singer's law practice is dedicated to investor protection. Mr. Singer's firm is based in Brooklyn, New York but represents investors in securities arbitration proceedings across the country, seeking recovery of investor losses in cases against stock brokerages, investment advisory firms, and various investment professionals. Mr. Singer also represents clients in commercial and complex litigation in state and federal court.

Mr. Singer represents investors in a wide array of case-types, including those involving unsuitable investment recommendations, churning, margin trading, securities-backed lending, failure to diversify, investment fraud, lost retirement savings, alternative investments, failure to supervise, and unauthorized trading. The types of products at issue in these cases run the gamut of the investment spectrum, including stocks, bonds, mutual funds, ETFs, options and derivatives, commodity futures, real estate investment trusts (REITs), tenancy-in-common (TIC) products, and master limited partnerships (MLPs).

Mr. Singer is an active member member of the Public Investors Arbitration Bar Association (PIABA) and lectures frequently on the subject of securities arbitration.

Kirk G. Smith, Esq.
Shepherd, Smith, Edwards & Kantas, LLP
Houston, TX

Kirk G. Smith is a managing partner at Shepherd, Smith, Edwards & Kantas, LLP, a nationally recognized plaintiffs securities litigation law firm. Mr. Smith's practice is focused exclusively on representing individual and institutional investors against financial institutions such as brokerage firms, banks, and trust companies. Mr. Smith handles cases across the U.S., typically involving issues such as retirement losses, broker and financial advisor misconduct, brokerage firm misconduct, fraud, and financial product failures,

Prior to becoming an attorney, Mr. Smith worked within the financial services industry as an investment advisor for a large brokerage firm as well as a boutique Wall Street firm, gaining invaluable knowledge of the investment processes, strategies, and marketing practices from both ends of the spectrum of firms in this industry. His diverse brokerage background, coupled with over 20 years of legal experience representing investors, enables Mr. Smith to deliver successful outcomes for his clients.

Mr. Smith is dedicated to providing personalized counsel and unrelenting advocacy for his clients, working to hold financial institutions accountable for their negligence and misconduct. He believes investors deserve to understand their rights and options when they suspect their lost savings and diminished retirement resources are the result of mismanagement by the brokers, investment advisors, and advisory firms that were trusted. Unflinching and undaunted in the face of financial institutions of any size or reputation, Mr. Smith works tirelessly to help his clients successfully navigate the legal process and recover their investment losses.

Since 1999, Mr. Smith has been involved in over 1,000 Financial Industry Regulatory Authority (FINRA) proceedings, from the assessment and filing stages, to the ultimate resolution either through settlement or verdict. This would include FINRA's predecessors, the National Association of Securities Dealers (FINRA) and the New York Stock Exchange (NYSE) and their respective Dispute Resolution forums. Mr. Smith has also participated in hearings through the American Arbitrations Association (AAA) and the National Futures Association (NFA), as well as State, Federal and Appellate Courts. Mr. Smith has extensive experience representing international investors, specifically clients from Latin America. He has won verdicts from the eight figure range to verdicts for smaller investors.

Jeffrey R. Sonn, Esq.
Sonn Law Group, PA
Aventura, Florida

During his career, Mr. Sonn has litigated numerous cases to successful resolution, recovering many millions of dollars for defrauded investors. He recently won a $50 million final judgment in Katz v. MRT Holdings, one of the few cases in the Private Securities Litigation Reform Act passed in 1995 to yield a final judgment on the merits.

Frequently, Mr. Sonn serves as a television commentator on securities fraud and ponzi scheme cases for CNBC, The CBS Sunday Morning Show, BBC Radio, ABC and MSNBC.

Mr. Sonn was the CNBC contributing expert on the Bernard Madoff Ponzi Scheme for the CNBC shows “On the Money” and “Scam of the Century, Bernie Madoff and the $50 Billion Dollar Heist.” Mr. Sonn recently appeared in the CNBC show “American Greed.”

Terri Sonn, Esq.
Sonn Law Group, PA
Aventura, Florida

Terri Sonn, Esq. specializes in commercial real estate transactions, and has been practicing in Florida for the past 33 years. Terri’s clients include developers, hotel owners, land infrastructure developers, shopping center owners, investors in “triple net” properties, and has conducted billions in real estate transactions for her clients. Terri’s practice includes drafting and negotiating purchase and sale agreements, financing agreements, commercial leases, brokerage and 1035 transactions. Terri has represented many commercial property owners in 1035 exchanges, which are tax free exchanges of like kind commercial properties, designed to allow seller to roll their profits from one commercial property into another commercial property. Terri also decades of experience as a commercial property investor/owner/developer.

Terri graduated from the University of Michigan, *with high distinction*, and the University of Miami School of Law, *cum laude*. Terri served as an Associate Editor of the University of Miami Law Review and the Entertainment and Sports Law Journal. Terri interned for US District Judge William Hoeveler. Terri’s awards and activities include the Order of the Iron Arrow Honor Society, Order of the Coif, the Moot Court Board Executive Committee, and the book award for administrative law, MiamiDade County Real Estate Pro Bono Award. Terri also served on the Miami Dade County Committee to modify and amend the South Florida Building Code, following Hurricane Andrew. Terri has lectured on Commercial Lending, Commercial Leasing, and Commercial Evictions for the Miami Dade County Bar Association, Real Property Committee.

Sean M. Sweeney, Esq.
Halling & Cayo S.C.
Milwaukee, Wisconsin

Sean M. Sweeney’s practice focuses on business litigation, civil litigation, stock broker fraud, business transactional law, and real estate law. Sean has experience litigating business and civil disputes as both plaintiff’s and defendant’s counsel, helping buyers and sellers complete real estate transactions, as well as experience drafting contracts ranging from small business contracts to plow a parking lot to large corporation contracts dealing with operating and maintaining real estate.

Sean earned his Juris Doctor (JD) and Masters of Business Administration (MBA) from Marquette University. He earned his Bachelor of Science Degree in Business Economics from Northern Arizona University.

Sean and his team offer Flat Fees on complex business litigation cases. You can learn more about flat fee business litigation here. He also runs www.The-Securities-Lawyers.com, in which Halling & Cayo’s Securities Litigation team discusses securities fraud, stockbroker employment disputes, and FINRA arbitration.

Amir Tadjedin, Esq.
Markun Zusman Freniere & Compton LLP
Portland, Oregon

Amir Tadjedin is an attorney with Markun Zusman Freniere and Compton. He defends broker-dealers and RIAs in all types of litigation and arbitration matters including SEC enforcement matters, state investigations, class actions, and state court matters on the west coast.

F. Chet Taylor, Esq.
Aries Legal
Minneapolis, Minnesota

I am uniquely qualified to pursue your claims against brokers/advisors, investment firms, fiduciaries, and others who might have harmed you financially. Not only do I have 30 years experience litigating those types of claims, but for a significant part of my career, I worked as an attorney inside the financial services industry. That experience gave me tremendous insight into how investment firms are supposed to operate – and how they actually operate. I now use that insight to your advantage in pursuing claims against investment firms.

After graduating cum laude from the University of Miami School of Law in 1988, I began my law career at Fredrikson & Byron, one of Minnesota's largest law firms. During my time there, I received top-notch litigation training and earned a wealth of experience working on complex litigation matters, including class actions. Although I handled a broad range of business litigation subjects, my focus at Fredrikson from day one was securities litigation, arbitration, and regulation. I represented both investors and investment firms in roughly equal numbers at Fredrikson. I then began working as an in-house attorney in the financial services industry. I first served as Deputy General Counsel, then Chief Litigation Counsel, and ultimately General Counsel with three Minneapolis-based investment firms.

In 2002, I joined Ted Meikle (a former Fredrikson partner) to form the law firm of Meikle & Taylor. Our "boutique" litigation firm focused on securities litigation and arbitration, class actions, and other complex business litigation. Ted and I experienced several significant successes in our practice, relishing the "David vs. Goliath" role we often played against much larger law firms. One such example was a multi-million-dollar settlement on behalf of about 40 investors against Deutsche Bank Securities. When Ted moved back to his native Utah, I formed Taylor Law Office, where I continued my focus on the litigation/arbitration of investment fraud claims, representing both investors and investment firms.

Taylor Law Office is now ARIES LEGAL – and the change is more than just a new name. Once I began focusing my law practice exclusively on advocacy for victims of investment fraud, consumer fraud, and employer misconduct, I sought a new company name and logo to depict this new emphasis. Although I do not follow astrology, I chose the name "Aries" because of the traits typically associated with that sign: assertive, enterprising, determined, confident, enthusiastic, passionate, and energetic. The symbol for Aries is the ram, which inspired our new logo. The ram is known for its strength, tenacity, and fearlessness. Those are qualities you may expect when you hire ARIES LEGAL to represent you.

Courtney Werning, Esq.
Meyer Wilson Co., LPA
Columbia, Ohio

As an attorney with Meyer Wilson, Courtney M. Werning devotes her practice to the representation of investors who have claims against their investment advisors and brokerage firms. Her practice includes litigation in state courts and various alternative dispute resolution venues, and she has tried arbitrations to verdict before the Financial Industry Regulatory Authority, the National Futures Association, and the American Arbitration Association. Courtney's recent civil cases and arbitrations have involved allegations related to unsuitable investment strategies, fraud and misrepresentation, Ponzi schemes, legal malpractice, elder financial abuse, and securities act claims. She has published several articles addressing investors' issues for the Ohio Association of Justice and the Ohio Division of Securities, and she frequently contributes to the Meyer Wilson Fraud and Investigation Blog. Courtney is admitted to practice law in the state of Ohio. She is currently a member of PIABA and is qualified as a FINRA Arbitrator. She is also a member of the Central Ohio Association for Justice, the Ohio Association for Justice, and the Ohio State Bar Association.

Joseph Wojciechowski, Esq.
Stoltmann Law Offices, P.C.
Chicago, Illinois

I am the managing partner at Stoltmann Law Offices and have been a licensed attorney since November 2009. I have been with Stoltmann Law Offices since March 2005. Prior to Stoltmann Law Offices, I had a short stint as a paralegal with a Chicago securities defense firm, Mallon & Johnson. I am responsible for the day to day operations of the firm, docket and case management. Personally, I handle all aspects of case management from potential client/case intake to trying the case. I have successfully briefed, argued, and defeated numerous motions to dismiss before dozens of FINRA arbitration panels and courts of law. I have successfully briefed motions to vacate arbitration awards before the Central District of California, Northern District of Illinois, and participated in appeals before the Ninth Circuit Court of Appeals. I have appeared before FINRA arbitration panels in hundreds of cases and successfully mediated over one hundred investor cases. I also have experience appearing in the Circuit Court of Cook County, Circuit Court of DuPage County, Northern District of Illinois, American Arbitration Association ("AAA") both under the Commercial Rules and Consumer Rules, and the Judicial Arbitration/Mediation Services (JAMS). My legal practice experience is mostly in representation of investor interests, whatever the venue. I also do commercial/business disputes, civil litigation, and class work.

I have been a member of PIABA since 2009 and have participated as a member of the SRO committee, annual meeting committee, and other subcommittees on discovery abuses and E-discovery. I am a former Editor-in-Chief and Managing Editor of the PIABA Bar Journal, previously authored the “Cases and Materials" article which appears in every journal, and have previously authored “Investors, Cornered.”

William B. Young, Jr., Esq.
Colling, Gilbert, Wright & Carter
Orlando, Florida

Prior to attending law school, Mr. Young spent over eight years working in the securities industry. During that time period, he was a Vice President at a global securities and money management firm located in Winter Park, Florida, holding licenses as a General Securities Registered Representative (Series 7), a Registered Investment Advisor Representative (Series 65), a Uniform Securities Agent State Law Examination (Series 63) and Florida Insurance and Variable Annuity. Mr. Young joined the firm of Colling Gilbert Wright & Carter in September 2006 after spending several years practicing plaintiff-side securities litigation with Hooper & Weiss, LLC. He continues to focus his practice on assisting clients recoup investment losses due to brokerage firm negligence and fraud.

Mr. Young also serves as a County Court Mediator in the Orange County Florida Court System. The Supreme Court of Florida, and the Florida Pro Bono Coordinators Association recognized Mr. Young for exceptional pro bono service in 2006 and each following year through 2019. Mr. Young has personally litigated and resolved several hundred FINRA (formerly NASD) arbitration Claims, many resulting in Claimants receiving monetary awards through live arbitration hearings.

Philip M. Aidikoff, Esq., *Director Emeritus*
Aidikoff, Uhl & Bakhtiari
Beverly Hills, California

Philip M. Aidikoff is a partner in the law firm of Aidikoff, Uhl & Bakhtiari and exclusively represents clients in securities arbitration and litigation. Mr. Aidikoff graduated from the University of California at Berkeley in 1969 where he was on the Dean's List and obtained his Juris Doctor degree from Southwestern University School of Law in 1975 where he was a member of Law Review. He is a past President and Director Emeritus of the Public Investors Arbitration Bar Association (PIABA). He served a five-year term (with three years as chair) on the National Arbitration and Mediation Committee of FINRA (formerly the NASD) which provides recommendations on rules, regulations and procedures governing arbitrations, mediations and dispute resolution. He served as one of three public members of the Securities Industry Conference on Arbitration (SICA), which was created with the support of the Securities and Exchange Commission to help protect the interests of public investors in securities arbitration. He also served as one of two investor advocates on the Securities Investor Protection Corporation (SIPC) Modernization Task Force. He served as a member of the FINRA Arbitration Task Force (2014-2015) which provided recommendations aimed at improving the transparency, impartiality and efficiency of securities arbitration. Mr. Aidikoff was recognized as a 2005, 2006, 2007, 2008, 2009, 2010, 2011, 2012, 2013, 2014, 2015 and 2016 Southern California Super Lawyer and was profiled in the February 2012 issue of Southern California Super Lawyers Magazine. He was also named by the National Law Journal as one of the 50 Litigation Trailblazers & Pioneers (2014). His legal rating as an attorney is the highest available "AV".

Mr. Aidikoff has spoken before numerous professional and lay groups on the topic of stockbroker abuse and the handling of arbitration and litigation involving brokers and firms. He has authored or co-authored a number of articles including: *Broker Abuse: Recovering for your Client*, Los Angeles Trial Lawyers Advocate (1993); *Take it or Leave it: Case Evaluation and Retention*, Practicing Law Institute Securities Arbitration Handbook (1995); *Recognizing and Evaluating Stockbroker Liability*, Consumer Attorneys Association of Los Angeles Convention (1995); *The Brave New World of Banks Selling Securities: Offline and Online*, Practicing Law Institute Securities Arbitration Handbook (1996); *Stockbrokerage Firm Liability: A Pre-Litigation Analysis*, Consumer Attorneys Association of Los Angeles Advocate (1996), reprinted in the Arizona Trial Lawyer Association Advocate (January 1997); *Recognizing and Guarding Against Fiduciary Abuse*, National Guardianship Association Annual Convention (1996); *Control Person Liability in the Securities Industry: A Legal Overview and Practical Applications*, Practicing Law Institute Securities Arbitration Handbook (1997); *Liability of Control Persons at Second Tier Firms*, Public Investors Arbitration Bar Association (1997); *Clearing Firm Liability: A Forward Looking Analysis*, Practicing Law Institute Securities Arbitration Handbook (1998); *Why Shouldn't Clearing Firms be Liable*, Public Investors Arbitration Bar Association (1998); *Motion Practice in Securities Arbitration: A Claimants Point of View*, Public Investors Arbitration Bar Association (1999); *Selective Recession and the Offset Defense in Securities Cases: A Survey of the Law,* Public Investors Arbitration Bar Association (2000); *After the Correction: Are Your Losses Recoverable?*, American Pathology Foundation (2001); *2001: An Update On Best Execution and Suitability Standards For Online Trading*, Public Investors Arbitration Bar Association (2001); *Arbitration: Can It Be Waived?*, Practicing Law Institute Securities Arbitration Handbook (2002); *Comments on The Claimants Bar On Proposed Changes In The Expungement Process*, The Association of the Bar of the City of New York (2002); *Due Diligence or Dont: Pre-Filing Considerations and Claim Drafting*, Public Investors Arbitration Bar Association (2003); *Confidentiality and Compliance Manuals: The Fight for Unfettered Access*, Public Investors Arbitration Bar Association (2004), republished in the Practicing Law Institute (2005); *From Wall Street to Main Street: A Guide to Litigation Over Hedge Funds Sold by Brokerage Firms to Retail Investors,* Public Investors Arbitration Bar Association (2005); *I Didn't Say That / Oh Yes, You Did: The Use of Court Reporters in Securities Arbitration,* Public Investors Arbitration Bar Association (2005); *Third Party Money Managers: Brokerage Firms Duty to Monitor and Resulting Liability*, Practicing Law Institute (2005); *A Practical Guide To The New NASD Code of Arbitration Procedure For Customer Disputes,* Practicing Law Institute Securities Arbitration Handbook (2006); republished Public Investors Arbitration Bar Association (2006); *Trying Asset/Mortgage Backed Securities Cases: A Practical Guide*, Public Investors Arbitration Bar Association (2007); *Wall Street Does It Again: The Auction Rate Securities Fraud,* Public Investors Arbitration Bar Association (2008); *The Prospectus Defense: Defeating It As A Matter of Fact and Law,* PIABA Bar Journal, *Vol. 16, No. 4* (2009); *Discovery of Regulatory Documents: Debunking the Myth of the SEC Privilege in Securities Arbitration*, Public Investors Arbitration Bar Association (2010); *Arbitrators Misclassified: Looking Back to Move Forward,* PIABA Bar Journal *Vol. 18, No. 1* (2011); *Discoverability Of Wells Submissions: What They Are And How To Get Them,* PIABA Bar Journal *Vol. 19, No. 2* (2012); *FINRA Six–Year Eligibility Rule 12206: The Purchase Date is Often Not the Triggering "Occurrence or Event Giving Rise to a Claim",* PIABA Bar Journal *Vol. 20, No. 1* (2013); *Market Adjusted Damages in the FINRA Forum*, PIABA Bar Journal *Volume 21, No. 2* (2014), reprinted in the Consumer Attorneys Associations for Southern California Advocate (April 2016);

and most recently published *The Use of Third Party Subpoenas to Determine a Brokerage Firm's Pre-Hiring Due Diligence and Post-Hiring Supervision*, Public Investors Arbitration Bar Association (2015).

Mr. Aidikoff has served on the faculty of the Practicing Law Institute (1996, 1997, 2002), NASD Fall Securities Conference (2002, 2004, 2005, 2006), NASAA Enforcement Conference (2002, 2004), NASAA Attorney/Investigator Training Conference (2006), University of Cincinnati School of Law Symposium-Twenty Years after Shearson v. McMahon (2007), SCMA Conference (2005), NERA Securities Litigation Seminar (2004), New York City Bar Securities Arbitration program (2002), Los Angeles County Bar Association Securities Arbitration program (2006, 2011, 2013 and 2015), the NASD faculty for training of discovery arbitrators, and on the JAMS faculty for training of securities arbitrators. He was a member of the NASD Neutral Roster Task Force (2005-2006), the FINRA Arbitrator Training Task Force (2009- 2010), FINRA Discovery Guide Task Force (2010–2013) and National Roundtable on Consumer and Employment Dispute Resolution, Pepperdine University 2012. He has appeared on CNBC, CNN/fn, PBS Nightly Business Report, National Public Radio, CBS Radio, and the Business Channel addressing investor rights topics, and has been quoted on securities matters in the Wall Street Journal, the Dow Jones News Service, Newsweek, Reuters, Fortune Magazine, Business Week, Money Magazine, Bloomberg News Service, Forbes, Medical Economics, Registered Representative, The New York Times, USA Today, The Los Angeles Times, The Washington Post and other national and local press. For five years he wrote a weekly column in the Palm Springs Desert Sun on issues of interest to investors. (www.securitiesarbitration.com)

Robert S. Banks, Jr., Esq., *Director Emeritus*
Samuels Yoelin Kantor, LLP
Portland, Oregon

Bob Banks has been practicing law for 36 years. He represents individuals and businesses in disputes with financial advisors, legal malpractice cases, and in business tort and minority shareholder rights cases. Mr. Banks has been an adjunct professor at Lewis and Clark Law School in Portland, Oregon. He practices at Banks Law Office PC in Portland, Oregon.

Honors

- 2017 Investor Champion Award, given by the North American Securities Administrators Association (NASAA)
- Distinguished Service Award, Public Investor Arbitration Bar Association (PIABA), 2016
- Distinguished Service Award, Federal Bar Association, Oregon Chapter
- Director Emeritus, PIABA
- PIABA President's Award," For Leadership Efforts In Protecting Investors Throughout the Country"
- Oregon Super Lawyers, 2006 – 2019, every year that it has existed in Oregon
- Chambers Best Lawyers In America
- Best Lawyers in America – Securities Law
- Martindale Hubbell Law Directory, Highest Rating
- Multi-Million Dollar Advocates Forum

Bar Leadership Positions

- Past President and 10-year board member, PIABA
- Past Chair, Oregon State Bar Securities Regulation Section
- Past Chair, Oregon State Bar Alternative Dispute Resolution Section
- Past President, Federal Bar Association, Oregon Chapter
- Past Chair, FINRA Arbitrator Training Committee Task Force, 2008-2009

Current Bar Committees

- Investor Representative Member, FINRA National Arbitration and Mediation Committee (NAMC)
- Chair, Rules and Procedures Subcommittee for FINRA's NAMC
- Member, National Federal Judicial Selection Committee, American Constitution Society

Selected Publications

- "Securities Arbitration" Chapter in Oregon State Bar Manual on Arbitration and Mediation, to be published in 2019
- PIABA Bar Journal Vol. 21, No. 3 2014, Muzzling the Claimant: Due Process Denied in FINRA Expungement Hearing
- Northwest Securities Institute CLE, Investment Portfolio and Brokerage Statement Danger Signals, July 2013 osbar.inreachce.com
- Practicing Law Institute, 1 Securities Arbitration 2006 at 225, The NASD's Explained Awards Rule Filing

· Practicing Law Institute, 1 Securities Arbitration 2003 at 253, Clearing Firms and the 2002 Uniform Securities Act: What You Didn't Know Could Have Hurt You
· Practicing Law Institute, Securities Arbitration 2001 at 565, Clearing Firms, The Uniform Securities Act, and Koruga v. Fiserv Correspondent Services, Inc.
· Practicing Law Institute, Securities Arbitration 2000 at 995, Investor Protection-Not! SIPC and The Securities Investor Protection Act of 1970
· Practicing Law Institute, Securities Arbitration 2008 A Comment On the Financial Industry Regulatory Authority's Proposed Rules On Motions To Dismiss.

Selected Speaking Engagements
· "Challenges in Administering a Large Receivership" National Association of Federal Equity Receivers (NAFER) Seattle, Washington, (January, 2019)
· "Recent Developments at FINRA" Northwest Securities Institute, Seattle (May 2018)
· "View From the Claimant's Perspective" CNA Insurance Broker-Dealer Conference, Tampa (March 2018)
· "Becoming a FINRA Arbitrator," with FINRA Executive Vice President and Director of Dispute Resolution, Richard Berry (April 2017)
· "Ethics Issues for Securities Lawyers" Oregon State Bar 35th Annual Northwest Securities Institute (April 2015)
· "What Every Securities Lawyer Should Know About Arbitration, Forum Selection, and Choice of Law Provisions" Oregon State Bar Securities Regulation Section Meeting (January 2014)
· "Remedies and Recompense: An Examination of Securities Arbitration and Class Actions" North American Securities Administrators Association (NASAA), Washington D.C., (October 7, 2013)
· "Detecting Anomalies in Investment Statements" Oregon State Bar seminar (July 16, 2013)
· "Recent Developments at FINRA," 3rd Annual Northwest Securities Institute seminar (May 2013)
· "Securities Arbitration Cases" Oregon Trial Lawyers Association Business Litigation Section Meeting (February 2011)

Selected Court Decisions
· Brown v. Price, WL 3207235 2017 (D. Or. 2017) Representing Aequitas Investors
· Amerivest v. Maloof, Oregon Court of Appeals, No. A144457 (Pending) Representing North American Securities Administrators Association as Amicus Curiae
· Boyer v. Salomon Smith Barney, Inc. 344 Ore. 583 (2008) Representing Public Investors Arbitration Bar Association as Amicus Curiae)
· Houston v. Seward & Kissel, LLP, 2008 U.S. Dist. LEXIS 23914 (March 27, 2008)
· Marshall, et al. v.McCown DeLeeuw, 391 F. Supp. 2d 880 (D. Idaho 2005)
· Estate of Aguirre v. Koruga (I) 2002 U.S. App. LEXIS 14632 (9th Cir. 2002)
· Koruga v. Fiserv Correspondent Services, Inc., 183 F. Supp.2d 1245 (D.Or. 2001), 2002 U.S. App. LEXIS 6439 (9th Cir. 2002)

Prior Clients
Bob has served a broad array of individuals, organizations and groups, including physicians, teachers, gas pipeline workers, attorneys, judges, investment advisors, accountants, NBA basketball players, a former US Congressman, FINRA (opposing broker expungement), North American Securities Administrators Association and Public Investors Arbitration Bar Association (as amici curiae), retirees, and many others who have been victims of negligent investment advice and
fraudulent conduct.

Educational Background
Reed College, B.A. 1977
University of Wisconsin Law School, J.D. 1982

Bar Memberships
Oregon, Washington.

Other
Finra Arbitrator Since 1989
Arbitration Services of Portland Arbitrator

Personal
Bob was born in New Jersey and grew up in upstate New York. He moved to Portland to attend Reed College and has considered himself to be an Oregonian for 40 years. He has completed 10 marathons, (2:46 PR), backpacked

throughout the NW, and is an avid fly fisherman. He is married to Valerie Banks (25 years) and they have two adult sons.

Hugh D. Berkson, Esq.
McCarthy, Lebit, Crystal & Liffman Co., LPA
Cleveland, Ohio

Hugh D. Berkson is a Principal attorney with McCarthy Lebit Crystal & Liffman Co., L.P.A., in Cleveland, Ohio, and focuses his practice in securities arbitration and litigation. After gaining extensive trial experience in both business and personal injury litigation, he began representing injured investors. Hugh tries and arbitrates investment cases and performs much of the required technical analysis.

Hugh obtained a business degree in Finance from the University of Texas at Austin and is a graduate of Case Western Reserve University School of Law, where he was a member of the Order of the Barristers and received both the American Jurisprudence Award (National Mock Trial) and the Jonathan M. Ault Mock Trial Prize. He later served as an Adjunct Professor at Case Western Reserve University School of Law, where he taught trial practice. Hugh is "AV Preeminent" rated by Martindale Hubbell, has been ranked as an Ohio "Super Lawyer" every year since 2013, and maintains a 10.0 "Superb" rating on Avvo.

Hugh has served on PIABA's Board of Directors since 2011, and his term as President of PIABA ends with this annual meeting.

Scot D. Bernstein, Esq., *Director Emeritus*
Law Offices of Scot D. Bernstein
Folsom, California

Mr. Bernstein has practiced law in California since 1980. For more than a dozen years, he has concentrated his practice on representing plaintiffs in class actions. He has been named class counsel in more than 25 cases, including both employment (wage-and-hour) and privacy class actions. He has been co-counsel in successful appeals that resulted in published decisions as well. He also has served as counsel in cases involving securities and franchise law violations, unfair competition, unlawful business practices and false advertising. And he has handled numerous arbitration matters, including one that resulted in an unusual judgment that is viewable on his website.

Mr. Bernstein studied engineering and economics at UCLA, where he received his bachelor's degree Magna Cum Laude in 1977 and was an officer of the UCLA chapter of Tau Beta Pi, the engineering honors society. He was a member of Omicron Delta Epsilon (economics honors society) and Phi Beta Kappa as well. He received his Juris Doctor degree at Boalt Hall School of Law, University of California at Berkeley, in 1980.

Mr. Bernstein is a member of the board of directors of the California Employment Lawyers Association ("CELA"), an association of more than 1,200 attorneys dedicated to representing employees in employment disputes. He currently co-chairs CELA's Legislative Committee and serves on its Wage and Hour Committee as well.

Mr. Bernstein served for eleven years as a director of the Public Investors Arbitration Bar Association ("PIABA"), a national association of attorneys dedicated to representing investors in disputes with the securities industry. He has published numerous articles in the PIABA Bar Journal and its predecessor, The PIABA Quarterly. Since 2008, he has worked hard to help PIABA defeat multiple attempts to pass legislation that would have created a broad new exemption for securities sold through general solicitation and general advertising in California. More recently, he has negotiated with the sponsors of those prior bills to arrive at a bill, supported by PIABA, which would be beneficial to investor protection. Mr. Bernstein has given continuing legal education lectures to PIABA, the North American Securities Administrators Association, CELA and other professional groups on investors' rights and remedies and on employees' rights under the wage and hour laws. He is a member of the National Employment Lawyers Association ("NELA") as well.

Reported Cases. Mr. Bernstein has served as co-counsel in successful federal and state appeals:
Kirby v. Immoos Fire Protection, Inc. (2012) 53 Cal.4th 1244 (co-counsel for successful appellants);
Stop Youth Addiction v. Lucky Stores, 17 Cal.4th 553, 950 P.2d 1086, 71 Cal.Rptr.2d 731 (1998) (attorney for amicus curiae in support of successful appellant);
Lippitt v. Raymond James Financial Services, et al., 340 F.3d 1033 (9th Cir. 09/22/2003) (co-counsel for successful appellant);
Lazarin et al. v. Total Western, Inc. (2010) 188 Cal.App.4th 1560, 116 Cal.Rptr.3d 596, review denied, Jan. 19, 2011, S188164 (co-counsel for successful appellant).

Mr. Bernstein has been recognized as a Northern California Super Lawyer® every year from 2010 through 2019.

Steven B. Caruso, Esq., *Director Emeritus*
Maddox, Hargett & Caruso P.C.
New York, New York

Steven B. Caruso, the Resident Partner in the New York City office of Maddox Hargett & Caruso, P.C. (www.investorprotection.com), concentrates his practice on the representation of individual, high net worth and institutional investors in securities arbitration and litigation proceedings.

Mr. Caruso is the Chairman and a public member of the National Arbitration and Mediation Committee ("NAMC") of the Financial Industry Regulatory Authority ("FINRA"); former Chairman of the Discovery Task Force Committee of FINRA; former member of the Nasdaq OMX BX Arbitration Committee; former member of the Securities Investor Protection Corporation (SIPC) Modernization Task Force; Director Emeritus and former President of the Public Investors Arbitration Bar Association ("PIABA"); testified before the U.S. House of Representatives, Committee on Financial Services, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, in March 2012 and September 2010; and has served as a judge for the Yale University Mock Trial Invitational Tournament and for Invest-Write, the national investment strategy writing competition sponsored by the Securities Industry & Financial Markets Association (SIFMA) Foundation.

Among the publications that Mr. Caruso has authored are ***An Introduction to FINRA's National Arbitration and Mediation Committee***, The Neutral Corner, FINRA Dispute Resolution, Vol. No. 1 (2018); *Post-Settlement Expungements: An Investor Protection Problem that Continues to Wait for a FINRA Solution*, Practising Law Institute, Securities Arbitration (September 2017); *Non-Attorney Representatives – Do They Present a Clear & Present Danger to the Integrity of FINRA Arbitration*, Association of the Bar of the City of New York, New York, N.Y. (May 2017); *Arbitrator Disclosures: Requests for Additional Information*, The Neutral Corner, FINRA Dispute Resolution, Vol. No. 4 (December 2016); *Ethical Implications of the Phantom Designation of Expert Witnesses in FINRA Securities Arbitration Proceedings*, Practising Law Institute, Securities Arbitration (September 2016); *Definition of a FINRA Customer: To Be or Not To Be – That Is the Ultimate Question*, Practising Law Institute, Securities Arbitration (July 2015); *Discovery in FINRA Arbitration*, The Neutral Corner, FINRA Dispute Resolution, Vol. No. 2 (2015); *FINRA Six-Year Eligibility Rule 12206: The Purchase Date is Often Not the Triggering Occurrence or Event Giving Rise to the Claim*, PIABA Bar Journal, Volume 20, No. 1 (September 2013); *All Public Arbitrator Panels: A More Level Playing Field*, Practising Law Institute, Securities Arbitration (August 2013); *Arbitrator Challenges Under the FINRA Code of Arbitration Procedure for Customer Disputes*, Practicing Law Institute, Securities Arbitration (August 2010); *The Mandatory Industry Arbitrator: An Endangered Species on the Precipice of Extinction*, Practising Law Institute, Securities Arbitration (August 2009); *Sunshine May be the Best Disinfectant for What Ails Securities Arbitration: A Discussion of the 2008 SICA Empirical Study of Fairness*, Practising Law Institute, Securities Arbitration (August 2008); *Effective Closing Statements From the Perspective of Counsel for the Customer-Claimant*, New York State Bar Association, Securities Arbitration 2007 (November 2007); *Essential Principles for Honorable Arbitrators*, Practising Law Institute, Securities Arbitration (August 2007); *Motions to Dismiss: A Predatory Tactic That Must be Extinguished*, Association of the Bar of the City of New York, New York, N.Y. (June 2007); *Ethical Standards for Securities Arbitrators: A Statistical Perspective of Potential Partiality (Bias)*, Practising Law Institute, Securities Arbitration (August 2006); *Arbitrator Training in the Securities Dispute Arena*, The Review of Securities & Commodities Regulation (January 2005); *Discovery Objections Which are Irrelevant, Unduly Burdensome and are Reasonably Calculated to Lead to the Concealment of Admissible Evidence*, New York State Bar Association, Securities Arbitration 2004 (October 2004); *Model Arbitrator Instructions: Luxury or Emerging Necessity*, Practising Law Institute, Securities Arbitration (August 2004); *Ethical Considerations in Settlement Agreements*, Association of the Bar of the City of New York, New York, N.Y. (June 2004); *Examination of the Adverse Broker: Unimpeachable Questions with an Internet Twist*, Practising Law Institute, Securities Arbitration (August 2001); *On-Line Trading: The New Frontier*, Practising Law Institute, Securities Arbitration (July 1999); and *NASD Arbitration Discovery Procedures : Knowing Your Customer From the Securities Professional Perspective*, American Bar Association, Section of Litigation, Committee on Securities Litigation (August 1995).

Jason Doss, Esq., *Director Emeritus*
The Doss Law Firm
Marietta, Georgia

Jason Doss has represented investors in NASD and FINRA arbitrations for approximately sixteen (16) years. The Doss Firm, LLC, established by Jason Doss in January 2009, is a successful law firm primarily devoted to representing aggrieved consumers across the United States against financial services companies for mismanaging investments and engaging in financial fraud. The attorneys of the firm have represented almost 1000 clients and have a combined 45 years of experience representing individual retail investors, institutional investors, and businesses in

financial fraud litigation, securities arbitrations, and collective and class actions. Jason Doss has represented dozens of investor clients in disputes with broker-dealers involving the unsuitable recommendations of life insurance products including but not limited to fixed-indexed and variable annuities. Since its inception, The Doss Firm has recovered tens of millions of dollars for investors and consumers.

In 2018, Jason Doss was selected by a federal court to serve as one of twelve attorneys to lead the Equifax Data Breach case on behalf of all consumers and small businesses across the country. The case is currently pending in the United States District Court, Northern District of Georgia.

Jason Doss was primarily responsible for originating a nationwide consumer class action consisting of approximately 420,000 policyholders in equity-indexed annuities against Allianz Life Insurance Company, *Linda L. Mooney et. al. v. Allianz Life Insurance Company of North America*, 06-cv-545, United States District Court of Minnesota. His former law firm Page Perry, LLC was co-lead counsel with two other firms.

Jason Doss has co-authored two books, Doss, J. and Frankowski, R., *A Practitioner's Guide To Securities Arbitration* (2013), American Bar Association (225 pages) and Armstrong, F. and Doss, J., *The Retirement Challenge: Will You Sink or Swim?* (Jan. 2009), FT Press, Prentice Hall Publishing (266 pages). *A Practitioner's Guide To Securities Arbitration* is used by law schools and practitioners across the country as a resource to help navigate the FINRA arbitration process. *The Retirement Challenge: Will You Sink or Swim?* is in bookstores across the country and is designed to help consumers avoid the pitfalls of investing and avoid becoming a victim of financial fraud.

Jason Doss is a past-President of the Public Investor Arbitration Bar Association (PIABA), a bar association of attorneys that represent investors in FINRA arbitrations. He also founded The PIABA Foundation, a Foundation devoted to preventing investment abuse, and currently serves as its President. In addition, Jason Doss helped create the Investor Advocacy Clinic at Georgia State University College of Law, a law clinic that represents investors *pro bono* in FINRA arbitration with investment losses too small for them to hire a private attorney.

Over the last ten years, Jason Doss has been quoted many times by major publications and news organizations about topics involving financial fraud including USA Today, The Wall Street Journal, The New York Times, Reuters, The Associated Press, Bloomberg, AARP Magazine, The Street, and The Atlanta Journal Constitution.

Michael S. Edmiston, Esq.
Jonathan W. Evans & Associates
Studio City, California

Michael S. Edmiston is an attorney at Jonathan W. Evans & Associates in Studio City, California. He has practiced with the firm since 2006. Prior to entering private practice, Michael served as a Senior Staff Attorney with NASD Dispute Resolution (now FINRA) in Los Angeles, California (1997-2001), and as a Business Manager with JAMS in Dallas, Texas and Orange, California (2001-2005).

His practice focuses on representing investors before FINRA, private commercial arbitration forums, and in state and federal court. His work continues to result in successful recoveries for clients by way direct negotiation, mediation, and contested arbitrations. Michael volunteers his time to Community Legal Aid SoCal working with senior citizens in a variety of civil and administrative matters.

In 2015, Michael became a Director of PIABA and will be serving as its EVP for 2020-2021. He previously served as the organization's Treasurer, Secretary, and as chair and co-chair of various committees. Michael has and continues to serve with the PIABA Bar Journal, including stints as Editor (2011-2012), Managing Editor (2013), Editor in Chief (2014-2015), and Advisor (2016 to present). He also authored and/or co-authored several articles and other materials for the Bar Journal and other publications.

Michael is a 1994 graduate of Whittier College, with B.A.s in both Business Administration and Economics. In 1997, he obtained his J.D. from Pepperdine University School of Law, and was admitted to the California Bar later that same year. He received his Master's Degree in Dispute Resolution from Pepperdine in 2001.

Benjamin P. Edwards, Esq.
University of Nevada, Las Vegas William S. Boyd School of Law
Las Vegas, Nevada

Benjamin Edwards is an Associate Professor of Law at the University of Nevada, Las Vegas. He researches and writes about securities and corporate law.

Samuel B. Edwards, Esq.
2020 PIABA President
Shepherd, Smith & Edwards, LLP
Houston, Texas

Sam Edwards is a Houston based Securities Litigation and Arbitration attorney with a national practice. Sam and his firm, Shepherd, Smith, Edwards & Kantas, focus primarily on representing investors who have been injured. That has included the representation of individual investors, small hedge funds, community banks, pension plans and municipalities, including state governments. Sam received his BA from the University of Texas at Austin and his law degree from the University of Houston Law Center. Sam began working on investment disputes while still in law school and joined his current firm shortly after graduation. Wanting to become even more specialized in this area of law, Sam made the seemingly insane decision to continue his education, earning an LL.M. from Georgetown University Law Center in 2015 in Securities Law and Financial Regulation. Sam received the Thomas Bradbury Chetwood Prize at Georgetown, an award given to the student with the highest grade point average in the LL.M. program.

Sam was previously has been a member of FINRA's National Arbitration and Mediation Committee, where he worked with other attorneys, both claimants and respondents attorneys, to help make better rules and procedures for FINRA arbitration participants. Sam has also been a member of PIABA for almost 20 years, serving on numerous committees, was formerly the editor-in-chief of the PIABA Bar Journal and has been on the PIABA Board of Directors since 2013. Sam is the current President of PIABA.

Adam Gana, Esq.
2020 PIABA Secretary
Gana Weinstein LLP
New York City, New York

Adam Gana is the managing partner of Gana Weinstein LLP. His practice focuses on all aspects of securities arbitration, complex commercial and business litigation. As a seasoned trial lawyer, Mr. Gana's experience includes litigation in both State and Federal Courts as well as in various alternative dispute resolution venues. As lead counsel, he has tried more than forty cases to verdict before the state and federal trial and appellate courts, AAA, JAMS, NFA and FINRA and has settled hundreds more cases through mediation and direct negotiation.

Mr. Gana was named in the New York *Super Lawyers Rising Stars*® for eight straight years (an honor given to the top 5% of attorneys), ranked AV® Preeminent™ by Martindale - Hubbell™ (the highest honor offered), and ranked by the National Trial Lawyers as one of the Top 100 attorneys in the state of New York.

Scott Ilgenfritz, Esq., *Director Emeritus*
Johnson, Pope, Bokor, Ruppel & Burns, LLP
Tampa, Florida

Scott C. Ilgenfritz is a partner in the law firm of Johnson, Pope, Bokor, Ruppel & Burns, LLP, and practices in the firm's Tampa, Florida, office. Scott has spent his entire thirty-four year legal career with Johnson, Pope. Over the years, Scott has had a varied commercial and business litigation practice, which has included securities arbitration and litigation, commercial tort litigation, professional malpractice litigation, corporate litigation, real estate-related litigation, and contract litigation. Since 1997, Scott has been Board certified by The Florida Bar as a Business Litigation Lawyer. Since 1997, Scott has been Board certified by The Florida Bar as as Business Litigation Lawyer. In 1992, Scott began representing investors in claims against broker/dealers, stockbrokers, investment advisors, and other financial professionals. Since the late 1990's, a primary focus of Scott's practice has been representing investors in securities arbitration and litigation matters. Scott has been a member of the Public Investors Arbitration Bar Association ("PIABA") since 1997. He served on PIABA's Board of Directors from 2008 until 2017. Scott served as President of PIABA from November, 2012, through October, 2013. During his term as President, he authored PIABA's expungement study. In 2017, Scott was recognized by PIABA as a Director Emeritus. Scott has been regularly recognized by his peers through inclusion in such publications as Florida's Super Lawyers (2007-2014) and Best Lawyers in America (2012-2017).

Marnie C. Lambert, Esq.
Lambert Law Firm, LLC
Columbus, Ohio

Marnie C. Lambert is a 1992 graduate of the Pepperdine University School of Law in Malibu, California. She has spent the past 15 years representing investors across the country in securities disputes with firms and representatives licensed by FINRA, the SEC and various states' securities divisions. She has represented investors in arbitration cases processed by FINRA, JAMS and AAA, as well as in court cases on a state and federal level.

Ms. Lambert has been an active member of the Public Investors Advocate Bar Association ("PIABA") since 2005, serving on the Board of Directors for the past 8 years (as Treasurer, Executive VP/President Elect and President from 2014-2017). She has participated in several panels over the years at PIABA Annual Meetings and she was panelist at the Practising Law Institute's Securities Arbitration Programs in New York City in 2017 and 2018. She has been an appointee to the Ohio State Bar Association ("OSBA") Annual LGBTQ (and Allies) Diversity and Inclusion Conference Planning Committee since 2011 (serving as Co-Chair in 2016) and she was an appointee to the OSBA's Litigation Section Council from 2005-2012.

Ms. Lambert has a reputation for her no-nonsense approach to cases and she is well-respected by clients, co-counsel, opposing counsel, arbitrators, mediators, and judges alike. She is licensed to practice law in the states of Ohio and California and in all United States District Courts in Ohio and California.

Christine Lazaro, Esq.
St. John's University School of Law
Queens, New York

Christine Lazaro is a Professor of Clinical Legal Education and the Director of the Securities Arbitration Clinic at St. John's University School of Law. Professor Lazaro is also Of Counsel to the Law Offices of Brent A. Burns, LLC, where she consults on securities arbitration and regulatory matters. Professor Lazaro has been a member of PIABA since 2008. She served as its President from October 2018 through October 2019, and currently serves on its Board of Directors. She is currently co-chair of the Association's Fiduciary Standards Committee. Professor Lazaro also serves on the FINRA Investor Issues Advisory Committee, and is a member of the Editorial Advisory Board of the Securities Arbitration Commentator, and occasionally contributes to its Arbitration Alerts. Professor Lazaro speaks and writes regularly on the topics of securities arbitration and the duties of brokers and brokerage firms.

Seth E. Lipner, Esq., *Director Emeritus*
Deutsch & Lipner
Garden City, New York

Seth E. Lipner is a Professor of Law at the Zicklin School of Business of Bernard M. Baruch College (CUNY) in New York City, and a member of the finn Deutsch & Lipner in Garden City, New York. Professor Lipner is the author of numerous scholarly articles and law books, including SECURITIES ARBITRATION DESK REFERENCE, co-authored with Professors Joe C. Long and William Jacobson, and published each year by West Publishing. As a member of Deutsch & Lipner, Mr. Lipner focuses his practice on representing investors and other individuals with grievances against providers of financial services.

Professor Lipner was a founder of PIABA when it was created in 1990. He served as President in 1994-1995, and again in 2000-200 I. He served as Secretary to the organization and on its Board of Directors since the organization's inception until 2006, and now holds the title "Director Emeritus." Professor Lipner has appeared on CNN, NPR, BBC and the Wall Street Journal Report, and is often quoted in publications such as Forbes, The New York Times, Reuters, Business Week, Newsweek, the Wall Street Journal, Newsday, the New York Law Journal and the National Law Journal. Professor Lipner speaks often to bar groups, and in continuing legal education programs, including the New York State Bar Association, Practicing Law Institute and PIABA. He served on the National Arbitration and Mediation Committee of the NASD from 1998 to 2002, and was at one time a member of the Board of Editors at Securities Arbitration Commentator. He is now on the Editorial Board of the PIABA Bar Journal, and is a regular contributor to the Journal.

Along with Lisa Catalano, he is the author of "The Tort of Giving Negligent Investment Advice," 39 University of Memphis Law Review 663 (2009). His most recent law review article, "The Expungement of Customer Complaint CRD Infonnation Following the Settlement of a FINRA Arbitration," is at 19 Fordham Journal of Corporate & Financial Law 57 (2013). Professor Lipner's numerous columns and other writings can be found at DeutschLipner.com. and Forbes.com.

Mark E. Maddox, Esq., *Director Emeritus*
Maddox Hargett & Caruso, P.C.
Fishers, Indiana

Mark E. Maddox is a founding partner of Maddox Hargett & Caruso, P.C., one of the nation's largest legal practices concentrating on the representation of securities investors. He has concentrated his career representing investors in disputes with stockbrokers and their firms.

From 1989 - 1991, Mr. Maddox served as the Securities Commissioner for the State of Indiana. During his tenure, he also served on the Indiana Governor's Initiative on Economic Development Policy Panel. Mr. Maddox also led the International Enforcement Committee of the North American Securities Administrators Association as its Chairperson. He served on the Board of Directors of the Public Investor Arbitration Bar Association from 1994 - 2002 and from 2014-2017, and was its President from 1998 - 2000. Mr. Maddox was also a public representative on the NASD Regulation's National Arbitration and Mediation Committee from 1996 - 1998 and 2003 – 2005, and was appointed its Chair for the 2004 – 2005 term. He was admitted to practice before the U.S. Supreme Court in February 1995.

In 1991, Mr. Maddox opened his current private practice that concentrates in the representation of investors in securities arbitration, litigation and regulation. He is a member of the Indianapolis Bar Association and the Indiana State Bar Association where he is a Past Chair of the Securities Sub-Committee. He is an adjunct professor at Butler University where he teaches Business Law to undergraduates.
Mr. Maddox is a graduate of Wabash College (magna cum laude), and earned his J.D. from Vanderbilt University in 1986. He has been a speaker and lecturer for various Continuing Legal Education and securities-related seminars and has been published extensively, most notably the book *Investor Rights for the 21st Century* (2001).

Thomas D. Mauriello, Esq.
Mauriello Law Firm, APC
San Clemente, California

Tom Mauriello founded the Mauriello Law Firm, APC in 1996 after working at a large national plaintiffs' securities class action form and several small firms. Tom focuses on investment and consumer disputes, with customer FINRA arbitrations constituting a large part of his practice. He also handles business litigation, consumer class actions, and appeals.

Tom is a member of the California, New Jersey and Pennsylvania bars. He received his BA from Brown University in 1983 and JD from the University of San Diego School of Law in 1988. Prior to law school, he worked as a paralegal in New York City for a law firm registering securities offerings with the SEC and state securities agencies. Following law school, Tom served as a judicial clerk to Judge Robert E. Cowen of the U.S. Court of Appeals for the Third Circuit.

Tom serves on the Administration of Justice Committee and the Mandatory Fee Arbitration Committee (as an attorney-client fee arbitrator) with the Orange County Bar Association. He also serves on the PIABA Legislation Committee and participated in PIABA's "Hill Day" in March 2016. From 2012 through 2015, Tom served as Co-Chair of the Legal Committee of the Angeles Chapter of the Sierra Club.

When he is not working, Tom enjoys spending time with his 17-year old daughter, surfing, wine tasting, fitness boot camp, traveling, and playing keyboards in several rock bands.

David P. Meyer, Esq.
2020 PIABA Executive Vice President/President Elect
Meyer Wilson Co., LPA
Columbus, Ohio

David P. Meyer is the managing principal of Meyer Wilson, a national law firm with offices in Ohio, Michigan and California.

Since starting the law firm in 1999, David has earned a national reputation for successfully representing investors who are victims of investment fraud. He has represented more than 1,000 individual investors from all across the country in securities arbitration and litigation. Meyer Wilson has also been appointed lead and co-lead counsel in numerous consumer class actions across the country. The firm also represents hundreds of clients who suffered serious injuries from dangerous drugs and defective medical devices. His firm has recovered more than $350,000,000 for its clients.

David is currently President-Elect of the Public Investors Advocate Bar Association (PIABA), a national association of lawyers who represent individual investors in cases of investment fraud. He is also President-Elect of the Ohio Association of Justice, the statewide bar of trial lawyers in the state of Ohio.

David P. Neuman, Esq.
Israels & Neuman PLC
Bellevue, Washington

David Neuman is an attorney who has been representing the interests of investors and consumers for over a decade. Before co-founding Israels & Neuman in the Summer of 2014, Mr. Neuman worked for over seven years at a law firm in Chicago which focused its practice on representing aggrieved and defrauded investors, mostly in FINRA arbitration. Throughout his years of experience, Mr. Neuman has recovered millions of dollars in hundreds of FINRA and court cases, on behalf of clients from over 40 states, as well as investors from the international community. In addition to representing investors in FINRA Arbitration, Mr. Neuman has represented investors in numerous courts throughout the U.S., as well as represented persons deceived by their insurance brokers and parties in shareholder disputes.

Mr. Neuman is currently on the Board of Directors of PIABA. He is currently the co-chair of the Membership Committee and has chaired several other committees. He is also an arbitrator with FINRA Dispute Resolution. David Neuman is admitted to practice law in Illinois, Washington, and Florida, as well as several federal courts.
Mr. Neuman graduated with Honors from the University of Illinois in December 2001 with a B.S. in Finance. He attended the Northern Illinois University College of Law and graduated Magna Cum Laude in May 2005. While at the NIU College of Law, Mr. Neuman was on Law Review and was an Associate Justice for the Moot Court Society. In addition, during his time at the NIU College of Law, he also was a research assistant for Professor David Gaebler and researched various areas of contract, commercial, and consumer law.

Timothy J. O'Connor, Esq.
The Law Offices of Timothy J. O'Connor
Albany, New York

Timothy J. O'Connor maintains a private practice of law in Albany, New York and is licensed in New York and Florida. He has been representing investors in securities brokerage customer claims since 1985. Mr. O'Connor has been a solo practitioner since 2005, after having been affiliated with Ainsworth Sullivan for 21 years.

A graduate of Middlebury College (A.B. Economics, 1980) and the University of Denver College of Law (J.D. 1984), Mr. O'Connor was nominated in the Fall of 2003 as the Inaugural Visiting Clinical Instructor for the Investor Rights Project Securities Arbitration Clinic of Albany Law School of Union University in Albany, New York, funded through the efforts of New York State Attorney General, Eliot Spitzer, from the proceeds of a settlement obtained against several national securities brokerage firms involving allegations of analyst fraud and wrongdoing. Mr. O'Connor served in this adjunct position through 2005.

In addition to his private practice, he is currently an Adjunct Lecturer at State University of New York at Albany, teaching courses in Law in Financial Market Regulation and Technology in Financial Market Regulation.

He has also widely written on a number of topics relating to the topic of investors rights. Most recently, "Trends in Supervisory and Clearing Firm Liability"(New York State Bar Association Continuing Legal Education Department – "Securities Arbitration and Mediation 2017: The Courage to Simplify" – April 6, 2017).

Darlene Pasieczny, Esq.
2020 PIABA Treasurer
Samuels Yoelin Kantor LLP
Portland, Oregon

Darlene Pasieczny (pronounced "Pah-shetch-nee") is a securities and fiduciary litigator, and leads the Investor Defenders practice group at Samuels Yoelin Kantor LLP, based in Portland, Oregon. Darlene works all stages of securities litigation and FINRA arbitration, fiduciary litigation in trust and estate disputes, elder financial abuse, complex civil litigation, and related appeals. She represents investors nationwide to recover investment losses caused by financial advisor misconduct or defective securities products. Previously, Darlene worked at Banks Law Office PC, where she developed her concentration on securities litigation and FINRA arbitration.

Darlene serves on the Board of Directors of the Public Investors Arbitration Bar Association (PIABA) and is a frequent speaker on FINRA arbitration, trust and estate matters, and elder financial abuse prevention, recognition, and recovery. Other professional affiliations include the Oregon State Bar, Washington State Bar, U.S. District Court for the State of Oregon, Multnomah Bar Association, and the Gus J. Solomon American Inn of Court. Darlene earned a B.A. from Reed College, *Phi Beta Kappa*, an M.A. from Columbia University, and J.D. from Lewis and Clark Law School, *magna cum laude*. www.InvestorDefenders.com

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Joseph C. Peiffer, Esq.
Peiffer Wolf Carr Kane & Conway, APLC
New Orleans, Louisiana

Joe is the Managing Shareholder of Peiffer Wolf Carr Kane & Conway, APLC. Based in the firm's New Orleans office, Joe has a wide-ranging practice focusing on cases that change lives. His practice consists of representing families affected by IVF clinic malfeasance, representing individuals and institutions that have been harmed by investment banks and brokerage firms, prosecuting ERISA class actions, and representing victims of labor trafficking, unscrupulous drug companies and those who have suffered catastrophic injury.
Joe currently represents many families that have had their dreams of having biological children taken from them due to the carelessness of IVF clinics. He is passionate about this work and understands the devastation that this causes individuals and families, who have lost eggs or embryos due to the malfeasance of these clinics.

In his financial services practice, Joe has represented hundreds of individual retirees against their brokers in FINRA arbitration. The highlights of this practice include representing 32 Exxon retirees in a 90-day FINRA arbitration against Securities America that resulted in a $22 million verdict – one of the largest ever awarded by a FINRA arbitration panel. He has also represented hundreds of Xerox and Kodak retirees against their brokers resulting from the brokers' fraudulent advice to retire and subsequent unsuitable investments. He has represented hundreds of families in cases involving private placements and Ponzi schemes.

His financial services fraud practice included representing approximately 25 municipalities and hospitals around the country in cases involving their issuance of auction rate securities. He also has litigated several ERISA class actions against large financial services firms regarding their imprudent investments of retirement money and conflicts of interest.

Joe has an active practice representing those who have been harmed by pharmaceutical products. He has represented or currently represents hundreds of clients in cases involving serious injuries sustained by drugs such as Pradaxa, Nuvaring, Invokana, Onglyza, and Essure. He represents approximately 800 clients in cases concerning harm caused by Xarelto.

Finally, Joe represents victims of human trafficking and labor exploitation. In one such case, his clients allege that the defendants have failed to pay overtime, improperly deducted for employee housing, and wrongfully held the plaintiffs' passports while in the United States. He has travelled extensively to the Philippines for this case and another involving a rig explosion.

The co-author of a treatise published by Thompson West, Litigating Business and Commercial Tort Cases, which is updated yearly since 2011. Joe teaches and lectures extensively throughout the country. He created and/or taught law school classes ranging from The Basics of Arbitration and Trial Advocacy, to Storytelling and Advocacy. He has spoken at many national conventions on a variety of topics, including prosecuting large and multi-client claims, brokers' deficient advice to retire, and voir dire and ERISA class actions and FINRA arbitration.

Joe is frequently quoted by national publications regarding FINRA arbitrations and mismanagement of retirement accounts. He has appeared in the USA Today, Wall Street Journal, Associated Press, New York Times, New York Daily News, Los Angeles Times, Business Week, Investment News, Reuters, and many other publications. He also has appeared on CNN.

Joe has received various awards and accolades. He was one of three Louisiana lawyers ranked by Chambers USA for securities litigation in 2011. He was named as one of the fifty Leaders in Law by New Orleans City Business Magazine. In 2014 Joe has been selected by his peers for inclusion in the 21st Edition of The Best Lawyers in America in the practice area of Commercial Litigation.

Joe is a leader of several national bar associations. He twice served as the chairman of the Business Torts Section of the American Association for Justice. He serves on the Board of Directors of PIABA – a nationwide bar association of lawyers who represent individuals and institutions in arbitrations to recover money lost by investment banks and brokerage firms. He was elected President of PIABA and will serve PIABA as its President until October 2015. Joe

graduated from Tulane School of Law, cum laude, in 1999. While at Tulane, he served on the Tulane Law Review and was involved with the Tulane Legal Assistance Program. Prior to attending Tulane, he graduated from Bowling Green State University in 1996, with a major in communications. While at Bowling Green, he worked as the General Manager of the campus radio station and City Editor of the daily newspaper.

Rosemary J. Shockman, Esq., *Director Emeritus*
Shockman Law Office, P.C.
Scottsdale, Arizona

Rosemary J. Shockman received her B.A. from the University of Minnesota and J.D., magna cum laude, from California Western University. She practices with the firm of Shockman Law Office, P.C. in Scottsdale, Arizona. The firm's practice is devoted primarily to the representation of public investors in actions with broker/dealers and others. The firm has represented hundreds of investors in claims against broker/dealers or stockbrokers.

Ms. Shockman is a past member of the Board of Directors, past President, and past chair of the Arbitrator Recruiting Committee for Public Investors Arbitration Bar Association ("PIABA").

She served two terms as a member of the FINRA (formerly NASD) National Arbitration and Mediation Committee.

Brian N. Smiley, Esq., *Director Emeritus*
Smiley Bishop & Porter LLP
Atlanta, Georgia

Brian Smiley is a partner in the firm of Smiley Bishop & Porter LLP. He was born in Augusta, Georgia, and grew up in Atlanta. He attended Emory College, where he was initiated into Phi Beta Kappa and from which he graduated with highest honors in 1975. Following graduation, he attended Emory University School of Law, where he served on the Board of Editors of the Emory Law Journal and was initiated into the Order of the Coif.

Upon graduation (with distinction) in 1978, Mr. Smiley received an appointment as a Trial Attorney in the United States Department of Justice. While at the Justice Department, Mr. Smiley acted as counsel for the Government in numerous cases that were deemed by the Attorney General to be of unusual importance to the United States, including Nixon v. United States, various constitutional cases and litigation involving the NATO treaty.

In 1981, Mr. Smiley returned to Atlanta from Washington, and entered into the private practice of law. As a litigator, Mr. Smiley has handled constitutional and civil rights suits, products liability claims, personal injury litigation, commercial controversies, shareholders' derivative suits, fidelity bond and RICO suits, and securities litigation and arbitration. For over 20 years, Mr. Smiley has concentrated in the securities field, primarily representing investors in FINRA arbitrations.

Mr. Smiley is the author of numerous articles including: "Stockbroker-Customer Disputes-Making a Case for Arbitration," (Georgia State Bar Journal, May 1987); "Spotting Common Forms of Stockbroker Misconduct" (The Verdict, Jan. - Feb. 1991); and, "The Law and Ethics of Witness Preparation" (Practicing Law Institute, 1998). He has spoken at numerous seminars sponsored by the Public Investors Arbitration Bar Association and has been quoted on securities matters in the national press.

Mr. Smiley is a frequent lecturer on the topics of stockbroker misconduct, the handling of litigation and arbitration involving stockbrokers, and legal ethics. He has testified as an expert at special hearings about the "penny stock" industry conducted by the Secretary of State of Georgia. Mr. Smiley testified before the United States Senate Committee on Banking, Housing and Urban Affairs, Securities Subcommittee, on the topics of "penny stock" fraud and securities industry arbitration.

In 2002, Mr. Smiley was appointed to the National Arbitration and Mediation Committee (NAMC). The 13 members of the NAMC advise the Board of Directors of FINRA, which is the world's largest forum for handling arbitration and mediation of disputes between clients and brokerage firms. The NAMC is actively involved in the drafting of arbitration rules and the recruitment, training and evaluation of arbitrators.

He has been elected to serve on the Board of Directors of PIABA for three terms and was honored to act as PIABA's President in 2008-2009.

Jeffrey R. Sonn, Esq.
Sonn Law Group, PA
Aventura, Florida

Jeffrey Sonn focuses his practice principally on securities litigation and arbitration matters, as well as business litigation, and class actions. Mr. Sonn is the managing partner of Sonn & Erez, and has handled over 1,000 of securities cases in his career. Mr. Sonn is "AV" rated by Martindale Hubbell, the highest rating for ethics and legal ability available by this independent ratings organization.

Mr. Sonn regularly lectures on the topic of securities litigation and securities fraud. Presently, Mr. Sonn is a lecturer at the Miami Dade County Police College on the subject of financial advisor fraud. Mr. Sonn has also served as a guest lecturer on securities fraud at the University of Miami Securities Law Clinic.

Mr. Sonn serves as a Director of the Public Investor Arbitration Bar Association (PIABA). Mr. Sonn is the author of many securities related articles, including Top *Ten Things to Do During a Final Hearing* (PIABA), *Top Ten Mistakes to Avoid in a Final Hearing* (PIABA), *Elder Abuse and the Securities Industry* (PIABA), *Ponzi Schemes, Picking up the Pieces from a Fallen House of Cards* ("Securities Arbitration in the Meltdown Era" Practicing Law Institute, 2009), *The ABC's of Mortgage Backed Securities* (PIABA), *The Broker Went Bankrupt—Now What*?(PIABA), *Survey of Arbitrator Misconduct, Group Arbitration Techniques (PIABA), How CPAs Can Detect Stockbroker Fraud,* and *Top Ten Mistakes To Avoid In an Arbitration Hearing,* as well as other securities-related publications.

During his career, Mr. Sonn has litigated numerous cases to successful resolution, recovering hundreds of millions of dollars for victims of investment fraud. He won a $50 million final judgment in Katz v. MRT Holdings, one of the few cases under Private Securities Litigation Reform Act passed in 1995 to yield a final judgment on the merits. Mr. Sonn also served on the Plaintiffs' Steering Committee that successfully negotiated a $70 million dollar settlement for hundreds of investors who were the victims of the Medical Capital and Provident Shale Royalties Ponzi Schemes.

Mr. Sonn has acted as trial counsel to verdict in a number of successful cases, including First Union vs. the FDIC and Hollywood Associates (a $16 million dollar verdict), Madhany v. Citgroup ($11.1 million verdict), Regas v. Painewebber (a $2.2 million dollar verdict), and Tartell v. Krieger Financial ($1.7 million dollar verdict).

Mr. Sonn has also represented United States Bankruptcy Trustees and Court appointed receivers as counsel in securities fraud and Ponzi scheme cases. Mr. Sonn has also served as an expert witness in securities fraud cases on issues involving attorneys fees.

Prior to founding the Firm in 1995, Mr. Sonn was associated with the Miami-based securities-litigation firm Gilbride Heller & Brown; and the bankruptcy law firm of Mishan, Sloto, Hoffman and Greenberg.

Mr. Sonn has served as a legal correspondent and commentator on securities fraud and Ponzi schemes for CNBC, CBS, BBC Radio, ABC and MSNBC. Mr. Sonn served as a CNBC legal contributor on the Bernard Madoff Ponzi Scheme for the CNBC shows "On the Money" and the documentary "Scam of the Century, Bernie Madoff and the $50 Billion Dollar Heist."

Mr. Sonn also appeared in the television show "American Greed" on CNBC, about representing victims of the $1 Billion Dollar Ponzi Scheme by convicted Fort Lauderdale attorney Scott Rothstein. Sonn & Erez represented victims in the Rothstein case and pushed the Rothstein law firm into bankruptcy when the fraud was discovered.

Mr. Sonn graduated from the University of Florida in 1984 and from University of Miami Law School in 1988. Mr. Sonn was an Associate Editor of the University of Miami InterAmerican Law Review.

Mr. Sonn is admitted to practice law in the State of Florida, the United States District Courts for the Southern and Middle Districts of Florida, and the 11th Circuit Court of Appeals.

Andrew J. Stoltmann, Esq.
Stoltmann Law Offices
Chicago, Illinois

Andrew Stoltmann, attorney and investor advocate, exclusively concentrates his practice in representing investors who are the victims of investment fraud. He has represented over one thousand individuals in lawsuits and securities arbitration actions against brokerage firms like LPL, Merrill Lynch, Morgan Stanley Dean Witter, Wachovia, Linsco, Prudential, Baird, Edward Jones, AG Edwards and Smith Barney and has tried approximately 80 cases. Previous to

opening the Stoltmann Law Offices P.C. he was a partner in a law firm concentrating its practice in the representation of investors in lawsuits, arbitration claims and class actions against brokerage firms.

Mr. Stoltmann is currently an adjunct securities law professor at Northwestern University School of Law in Chicago. Mr. Stoltmann was the Editor-In-Chief of the PIABA (Public Investor Arbitration Bar Association) Bar Journal, a law journal for the national association of securities attorneys who represent investors in claims against brokerage firms and stockbrokers, from 2001 through 2005. Mr. Stoltmann is also the co-author of the book “Investor Rights for the Year 2000 and Beyond.”

After graduating from the University of Wisconsin (Madison) with a Bachelor of Business Administration degree, Mr. Stoltmann worked as a licensed stockbroker for Olde Discount and Merrill Lynch. While in law school at DePaul University, Mr. Stoltmann clerked at the Chicago NASD Dispute Resolution office, where 95% of securities arbitration cases are decided.

Mr. Stoltmann has appeared as a guest providing legal opinions, commentary and analysis on CNN, CNBC, BBC, CBC, CBS, CNN-FN, Bloomberg TV and National Public Radio. Mr. Stoltmann has been quoted in various publications worldwide including the Wall Street Journal, Christian Science Monitor, Business Week, Forbes, Fortune, USA Today, Chicago Tribune, Los Angeles Times, Kiplinger’s, Jerusalem Post, London Post, London Free Press, The Guardian (UK), Daily Telegraph of London, Montreal Gazette, MaClean’s, Calgary Herald, Toronto Globe & Mail, Toronto Star, Mainichi Daily News (Tokyo), China Daily (Beijing), Mail & Guardian (Johannesburg), National Post, and The Scotsman (Edinburgh).

Mr. Stoltmann is a member of PIABA (Public Investor Arbitration Bar Association), ATLA (Association of Trial Lawyers of America), the Chicago Bar Association, Illinois State Bar Association and is admitted to the United States District Court for the Northern District of Illinois and the Eastern District of Wisconsin.

THE FINANCIAL INDUSTRY REGULATORY AUTHORITY'S DISPUTE RESOLUTION ACTIVITIES

Revised August 5, 2020

I. BACKGROUND

The Financial Industry Regulatory Authority (FINRA) administers a dispute resolution forum for investors, brokerage firms, and their registered employees in the U.S. through its network of 70 hearing locations, including at least one in each state and Puerto Rico. FINRA administers between 3,500 and 8,500 arbitrations and numerous mediations annually. FINRA maintains a diverse roster of over 8,000 arbitrators and 270 mediators. The National Arbitration and Mediation Committee (NAMC), which is composed of investor, industry, and neutral (arbitrator and mediator) representatives, provides policy guidance to FINRA's Dispute Resolution staff. A majority of the NAMC members and its chair are public. FINRA is regulated by the United States Securities and Exchange Commission (SEC).

FINRA's Dispute Resolution program is administered out of four regional offices: Northeast, Southeast, Midwest, and West, located in New York City, Boca Raton, Chicago, and Los Angeles, respectively, with headquarters in New York City. Contact information for the regional offices, as well as for other FINRA staff, is available on FINRA's website at **https://www.finra.org/arbitration-mediation/dispute-resolution-regional-offices-and-hearing-locations**. Below is a map showing the hearing locations and the regional offices to which they are generally assigned:



Below are highlights on: Statistics and Trends; FINRA's Response to COVID-19; Recent Significant Rule Changes; Proposed Rule Changes; Regulatory Notice on Forum Selection; Significant Initiatives; FINRA Neutrals; Technology Initiatives; and Mediation.

II. STATISTICS AND TRENDS

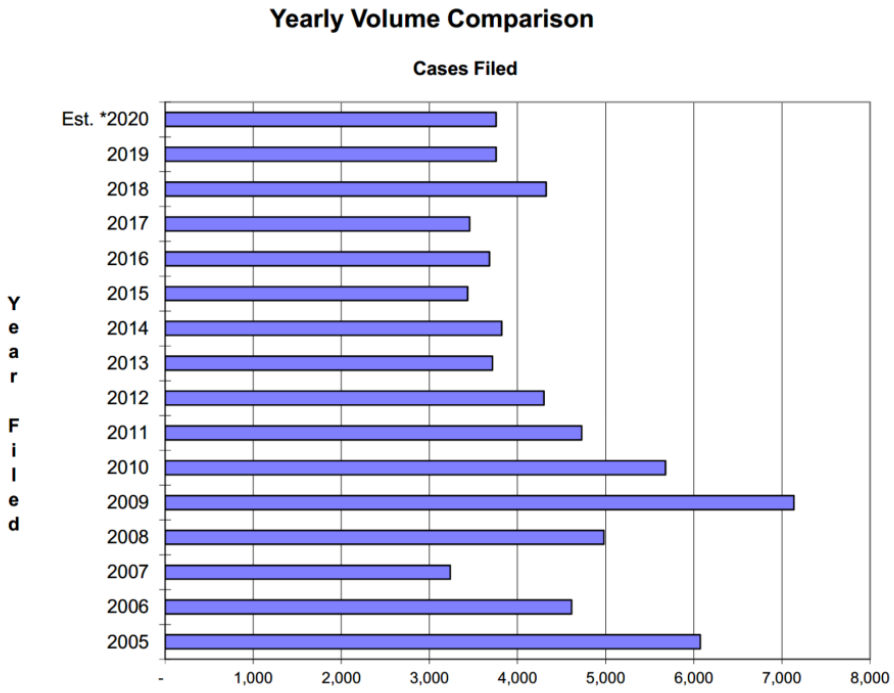
Arbitration case filings increased in June 2020 compared to June 2019. In June 2020, parties filed 1,878 cases – a 4% increase from the 1,801 cases filed in June of 2019. Customer claims decreased in June 2020 compared to June 2019. In June 2020, 46% of filed claims were intra-industry cases.

Mediation cases decreased in June 2020 compared to June 2019. In June 2020, 241 mediation cases were filed compared to 287 in June 2019.

Case Filing Statistics for 2020 - This section provides key filing data and trends.

Overall arbitration case filings:

- June 2020: 1,878 (4% increase compared to June 2019)



Overall mediation case filings:

- June 2020: 241 (16% decrease compared to June 2019)

Customer Award Statistics

- Cases in which customers were awarded damages in June 2020:

- Overall: 36% (45% in 2019, 40% in 2018, and 43% in 2017).

- Regular Hearing cases (not including cases decided by Special Proceeding or review of documents only): 36% (45% in 2019, 42% in 2018 and 45% in 2017).

Case Processing Statistics

Processing times from service of the claim to close of the case in June 2020:

- Overall: 15.2 months (8% increase compared to June 2019)

- Hearing cases: 14.9 months (14% decrease compared to June 2019).

- Paper cases (decided on the documents submitted without a hearing): 5.1 months (12% decrease compared to June 2019).

- Special Proceeding cases: 7.1 months (22% increase compared to June 2019).

Percentage of all arbitration cases closed by award in June 2020:

- 14% (compared to 16% in 2019, 17% in 2018 and 18% in 2017).

- In June 2020, customer cases closed by settlement approximately 75% of the time.

FINRA Dispute Resolution Services
Top 15 Controversy Types in Customer Arbitrations Through June

Type of Security *		2020 Cases Served	2019	2018	2017	2016
Breach of Fiduciary Duty	**Through June**	842	981	1,183	920	1,004
	Year-End	--	2,053	2,290	1,899	2,002
Negligence	**Through June**	763	884	973	816	936
	Year-End	--	1,826	1,974	1,662	1,862
Failure to Supervise	**Through June**	713	818	959	794	917
	Year-End	--	1,731	1,935	1,621	1,802
Misrepresentation	**Through June**	679	742	984	771	814
	Year-End	--	1,688	1,775	1,663	1,670
Suitability	**Through June**	626	708	1,021	774	788
	Year-End	--	1,580	1,779	1,606	1,606
Breach of Contract	**Through June**	623	722	830	641	771
	Year-End	--	1,563	1,711	1,318	1,495
Omission of Facts	**Through June**	593	664	852	684	675
	Year-End	--	1,468	1,547	1,493	1,606
Fraud	**Through June**	506	695	864	639	646
	Year-End	--	1,499	1,707	1,389	1,301
Manipulation	**Through June**	170	166	128	138	137
	Year-End	--	384	302	299	236
Violation of Blue Sky Laws	**Through June**	153	291	397	228	166
	Year-End	--	657	810	547	344
Unauthorized Trading	**Through June**	91	106	128	146	173
	Year-End	--	197	245	263	362
Elder Abuse**	**Through June**	91	101	117	0	--
	Year-End	--	207	216	61	--
Churning	**Through June**	73	91	102	127	144
	Year-End	--	167	205	219	254
Errors-charges	**Through June**	42	33	45	23	23
	Year-End	--	98	81	66	56
Execution Error	**Through June**	30	32	39	23	47
	Year-End	--	51	75	53	85

* Each case can be coded to contain multiple controversy types. Therefore the columns in this table cannot be totaled to determine the number of cases served in a year.
**These categories were not tracked for the years in which no data appears.

FINRA Dispute Resolution Services
Top 15 Security Types in Customer Arbitrations Through June

Type of Security *		2020 Cases Served	2019	2018	2017	2016
Common Stock	**Through June**	196	243	324	297	335
	Year-End	--	436	579	604	646
Private Equities	**Through June**	145	63	54	69	60
	Year-End	--	149	111	111	114
Real Estate Investment Trust	**Through June**	136	112	91	103	93
	Year-End	--	236	205	177	184
Municipal Bonds	**Through June**	98	331	462	209	214
	Year-End	--	702	971	565	433
Options	**Through June**	97	118	103	63	61
	Year-End	--	204	150	127	124
Mutual Funds	**Through June**	95	265	341	193	133
	Year-End	--	526	731	447	352
Limited Partnerships	**Through June**	84	53	77	98	75
	Year-End	--	128	144	183	199
Municipal Bond Funds	**Through June**	81	338	446	205	663
	Year-End	--	717	959	558	480
Exchange-Traded Funds	**Through June**	51	60	104	74	72
	Year-End	--	138	167	131	133
Variable Annuities	**Through June**	48	53	51	73	51
	Year-End	--	109	105	129	115
401(k)	**Through June**	41	26	45	38	2
	Year-End	--	58	94	69	27
Annuities	**Through June**	38	49	51	58	64
	Year-End	--	97	101	115	127
Corporate Bonds	**Through June**	38	44	70	57	66
	Year-End	--	74	135	119	154
Government Securities	**Through June**	30	188	222	69	16
	Year-End	--	431	519	229	96
Business Development Company	**Through June**	24	13	6	5	--
	Year-End	--	26	20	14	--

* Each case can be coded to contain multiple security types. Therefore the columns in this table cannot be totaled to determine the number of cases served in a year.

FINRA Dispute Resolution Services
Top 15 Controversy Types in Intra-Industry Arbitrations Through June

Type of Security *		2020 Cases Served	2019	2018	2017	2016
Breach of Contract	**Through June**	157	175	177	203	195
	Year-End	--	345	413	403	389
Promissory Notes	**Through June**	127	120	135	138	204
	Year-End	--	240	261	296	401
Libel, Slander, or Defamation	**Through June**	73	74	90	51	62
	Year-End	--	135	166	117	124
Libel or Slander on Form U-5	**Through June**	73	60	77	64	59
	Year-End	--	119	135	136	124
Compensation	**Through June**	72	71	79	77	73
	Year-End	--	135	168	161	163
Wrongful Termination	**Through June**	54	55	65	59	57
	Year-End	--	102	122	116	127
Suitability	**Through June**	41	15	53	12	1
	Year-End	--	17	63	59	17
Commissions	**Through June**	38	40	42	56	29
	Year-End	--	82	95	103	60
Misrepresentation	**Through June**	27	26	42	12	5
	Year-End	--	29	68	54	21
Discrimination or Harassment**	**Through June**	20	26	24	16	32
	Year-End	--	46	38	37	58
Breach of Fiduciary Duty	**Through June**	13	22	25	17	9
	Year-End	--	30	39	52	18
Raiding Disputes	**Through June**	13	11	18	14	16
	Year-End	--	21	37	33	42
Fraud	**Through June**	11	9	13	7	3
	Year-End	--	11	24	26	11
Indemnification	**Through June**	10	9	7	10	6
	Year-End	--	17	20	25	14
Partnerships	**Through June**	8	6	3	2	5
	Year-End	--	15	13	7	11

* Each case can be coded to contain multiple controversy types. Therefore the columns in this table cannot be totaled to determine the number of cases served in a year.

Comparison of Results of All-Public Panels and Majority-Public Panels in Customer Claimant Cases

Year Decided	Cases Decided by All-Public Panels	Number of Cases Decided by All-Public Panels Where Customer Awarded Damages	Percentage of Cases Decided by All-Public Panels Where Customer Awarded Damages	Cases Decided by Majority-Public Panels	Number of Cases Decided by Majority-Public Panels Where Customer Awarded Damages	Percentage of Cases Decided by Majority-Public Panels Where Customer Awarded Damages
2015	163	77	47%	84	38	45%
2016	145	63	43%	72	26	36%
2017	137	66	48%	71	26	37%
2018	158	67	42%	58	27	47%
2019	149	79	53%	47	13	28%
YTD 2020	41	14	34%	17	5	29%

In June 2020, investors prevailed 34% of the time (14 out of 41 cases) in cases decided by all-public panels and 29% of the time (5 out of 17 cases) in cases decided by majority-public

panels. To find more information on case statistics and award outcomes please visit the **Dispute Resolution Statistics** page at FINRA.org.

III. FINRA'S RESPONSE TO COVID-19

Thanks to a strong Technology team and broad remote-work functionality already in place, FINRA was well equipped for this unforeseen challenge and we remain fully operational during this time. We successfully migrated our staff to full-time remote work without issue and without impacting our productivity. Certain functions (which are largely paper-based) required some creative adjustments in order to convert to a remote-based operation. Nevertheless, we lost no time in making the necessary changes to ensure that all aspects of our claim intake, case processing, award tracking, and suspension processes remain intact and operational.

Impact on Arbitration and Mediation Hearings

In response to the evolving coronavirus disease 2019 (COVID-19), at this time, FINRA has decided to administratively postpone all in-person arbitration and mediation proceedings scheduled through October 2, 2020. If parties have an in-person hearing or mediation session scheduled through this date, FINRA staff will contact them to reschedule or discuss remote scheduling options. Postponing a hearing does not affect other case deadlines. All case deadlines will continue to apply and must be timely met unless the parties jointly agree otherwise. More information is available on FINRA.org **here**.

Further, FINRA is waiving postponement fees when parties stipulate to adjourn in-person hearing dates scheduled from October 5 through December 31, 2020. To avoid postponement fees, parties must provide written notice of the stipulation to adjourn more than 20 days prior to the first scheduled hearing date. Parties stipulating to adjourn in-person hearing dates should also consider stipulating to changing other case deadlines.

FINRA is also offering parties the remote use of mediation through October 31, 2020 at significantly reduced fees.

FINRA Dispute Resolution Services Arbitrator Resource Guide for Virtual Hearings

FINRA is offering virtual hearing services (via Zoom and teleconference) to parties in all cases by joint agreement or by panel order. These services provide high-quality, secure, user-friendly options for conducting video and telephonic hearings and sharing documents remotely. More information about Zoom security features for arbitrations and mediations is available on FINRA.org **here**. Staff is available to schedule virtual hearings and provide technical support.

FINRA has also released an online resource guide for arbitrators conducting hearings using Zoom, which is available **here**. This guide includes information about the equipment arbitrators will need, promoting fairness and impartiality throughout Zoom hearings, and best practice tips for topics like participant etiquette, when and how often to take breaks, and how

to set up your Zoom background to minimize distractions. Arbitrators should contact their case administrator with additional questions about virtual hearings.

IV. RECENT SIGNIFICANT RULE CHANGES

Rule Change to Amend the Codes to Apply Minimum Fees to Requests for Expungement of Customer Dispute Information

On May 26, 2020, the SEC approved a proposed rule change to amend the Customer Code and the Industry Code (together, Codes) to apply minimum fees to requests for expungement of customer dispute information. The proposed rule change would amend Part IX (Fees and Awards) of the Codes to apply minimum filing fees to requests for expungement of customer dispute information, whether the request is made as part of the customer arbitration or the associated person files an expungement request in a separate arbitration (straight-in request). The proposed rule change would also apply a minimum process fee and member surcharge to straight-in requests, as well as a minimum hearing session fee to expungement-only hearings.

These amendments apply to cases filed on or after September 14, 2020. Please see **Regulatory Notice 20-25** for more information about this rule filing.

Rule Change to Amend the Membership Application Program (MAP) Rules to Address the Issue of Pending Arbitration Claims

On March 26, 2020, the SEC approved a proposal to amend the MAP rules to prevent a member firm with substantial arbitration claims from avoiding payment of the claims that go to award or result in a settlement by shifting its assets to another firm and closing down. The rule change will also address situations in which member firms are considering hiring individuals with pending arbitration claims where there are concerns about payment of those claims should they go to award or result in a settlement, as well as concerns about the adequacy of the supervision of those individuals by the hiring member firm.

The changes are effective on September 14, 2020. Please see **Regulatory Notice 20-15** for more information.

Rule Change to Expand Options Available to Customers if a Firm or Associated Person is or Becomes Inactive

On February 20, 2020 the SEC approved a proposal to amend FINRA Rules 12100, 12202, 12214, 12309, 12400, 12601, 12702, 12801, and 12900 of the Customer Code to expand a customer's options to withdraw an arbitration claim if a member or an associated person becomes inactive before a claim is filed or during a pending arbitration. In addition, the amendments will allow customers to amend pleadings, postpone hearings, request default proceedings and receive a refund of filing fees in these situations.

The amendments are effective for cases filed on or after June 29, 2020. See **Regulatory Notice 20-11** for more information.

V. PROPOSED RULE CHANGES

Proposed Rule Changes Approved by the FINRA Board

Proposed Rule Change to Increase Arbitrator Chairperson Honoraria

At its **December 2019** meeting, the FINRA Board of Governors (Board) approved filing with the SEC proposed amendments to the Codes to increase some arbitration fees for the sole purpose of increasing arbitrator chairperson honoraria. Under this proposal, the chairperson of the panel would receive an extra $250 per day instead of the current $125 rate. The proposed amendments would also create a new $125 chairperson honorarium for each prehearing conference in which the chairperson participates. To cover these honoraria increases, FINRA would increase the member firm surcharges and case processing fees for claims larger than $250,000 or claims for non-monetary or unspecified damages. The proposal would also increase filing fees and hearing session fees for customers, associated persons and member firms bringing claims of more than $500,000 or claims for non-monetary or unspecified damages; arbitrators may allocate responsibility for the hearing session fees in their award. FINRA believes that the proposed chairperson honoraria increases are needed to attract both new and experienced arbitrators to become chairpersons. The proposed amendments will next be filed with the SEC.

Proposed Amendments to the Codes of Arbitration Procedure Relating to Requests to Expunge Customer Dispute Information

At its **December 2018** meeting, the Board approved proposed amendments to the Codes to codify the Notice to Arbitrators and Parties on Expanded Expungement Guidance. The proposed rule would also prevent associated persons from filing second requests to expunge the same customer dispute information that was the subject of a prior request that a panel or court denied. The proposed amendments will next be filed with the SEC.

At its **September 2019** meeting, the Board approved proposed amendments to the Codes to create, among other things, a roster of arbitrators with enhanced training and experience from which a panel would be selected in certain instances to decide an associated person's request to expunge customer dispute information. The proposed amendments will next be filed with the SEC.

Proposal to Prohibit Compensated Non-Attorney Representatives (NARs) in Arbitration and Mediation

At its **December 2018** meeting, the Board approved filing with the SEC proposed amendments to the Codes of Arbitration and Mediation Procedure to greatly limit compensated non-attorney representatives (NARs) from practicing in the FINRA arbitration and mediation forum. The rule proposal would also specify that a student enrolled in a law school, who is participating in a clinical program or its equivalent, and is practicing under the supervision of an attorney pursuant to state law, is allowed to represent parties in arbitration and mediation. It would also include guidelines for resolving issues regarding the qualifications of NARs or law students in the forum. The proposed amendments will next be filed with the SEC.

Regulatory Notices Seeking Comments

Regulatory Notice on Discovery of Insurance Information (Regulatory Notice 18-22)

On July 26, 2018, FINRA published **Regulatory Notice 18-22** seeking comment on proposed amendments to the Discovery Guide's Firm/Associated Persons Document Production List (List 1). Specifically, the amendments would require firms and associated persons, upon request, to produce documents concerning third-party insurance coverage in customer arbitration. The proposed amendments would strictly limit the circumstances under which insurance coverage information could be presented to the arbitrators. The new list item would state that it may be prejudicial for arbitrators to be given information related to coverage or lack of coverage by liability insurance.

Any party wishing to submit insurance-related evidence at a hearing would have to demonstrate to the arbitration panel that there are extraordinary circumstances warranting admission of this information, or the existence of an insurance policy is directly related to the dispute outlined in the statement of claim.

The comment period ended September 24, 2018.

VI. REGULATORY NOTICE ON FORUM SELECTION PROVISIONS INVOLVING CUSTOMERS, ASSOCIATED PERSONS AND MEMBER FIRMS

In July 2016, FINRA published **Regulatory Notice 16-25** to remind member firms that customers have a right to request arbitration at FINRA's arbitration forum at any time and do not forfeit that right under FINRA rules by signing any agreement with a forum selection provision specifying another dispute resolution process or an arbitration venue other than the FINRA arbitration forum. In addition, FINRA reminded member firms that FINRA rules do not permit member firms to require associated persons to waive their right to arbitration under FINRA's rules in a pre-dispute agreement.

VII. SIGNIFICANT INITIATIVES

List of Member Firms and Associated Persons with Unpaid Customer Arbitration Awards

In October 2018, FINRA posted a list on its website of firms and individuals responsible for unpaid customer arbitration awards. FINRA has provided this information in an effort to increase transparency regarding those firms and individuals with unpaid arbitration awards, and to make this information more readily accessible to investors. The list includes the names of firms and individuals whose FINRA registration has been terminated, suspended, canceled or revoked, or who have been expelled from FINRA. This information will also continue to appear on the firms' or individuals' BrokerCheck reports. FINRA updates this information on a regular basis.

The list is available on the **Member Firms and Associated Persons with Unpaid Customer Arbitration Awards** page on FINRA.org.

Expanded Expungement Guidance for Arbitrators and Parties

Notice to Arbitrators and Parties: In October 2013, the forum sent to all arbitrators a notice and published on its website guidance for parties and arbitrators concerning expungement requests. The guidance emphasizes the extraordinary nature of expungement relief and advises arbitrators to consider the importance of the Central Registration Depository (CRD) information to regulators, firms, and investors (through BrokerCheck) when considering requests for expungement. The guidance encourages arbitrators to request any documentary or other evidence they believe is relevant to the expungement request, particularly in cases that settle before an evidentiary hearing or in cases where only the requesting party participates in the expungement hearing. It also suggests that arbitrators ask the broker requesting expungement to provide a current copy of his or her BrokerCheck report when determining the appropriateness of expungement. The guidance further recommends that arbitrators identify in the award the specific documentary evidence that they relied upon when recommending expungement.

On July 22, 2014, the SEC approved FINRA Rule 2081, which prohibits conditioned settlements, and it became effective on July 30, 2014. In August 2014, the forum sent to all arbitrators a notice and published on its website updated guidance wherein we addressed settlement payments and prohibited conditions relating to expungement of customer dispute information. The updated guidance reminds arbitrators to consider whether the party seeking expungement contributed to the settlement. Further, the updated guidance provides that if arbitrators learn of prohibited conditions, as described in Rule 2081, they should consult FINRA's procedures on disciplinary referrals.

In September 2014, we e-mailed to arbitrators a notice and published on our website updated guidance wherein we addressed the importance of allowing customers and their counsel to participate in the expungement hearing in settled cases. This section of the updated guidance reminds arbitrators to allow the customer, among other things, to introduce documents and evidence at the expungement hearing, cross-examine the broker and other witnesses called by the party seeking expungement, and to present opening and closing arguments if the panel allows any party to present such arguments.

In December 2014, we published on our website updated guidance about cases in which an associated person will file an arbitration claim against a member firm solely for the purpose of seeking expungement, without naming the customer in the underlying dispute as a respondent. This section of the updated guidance reminds arbitrators to order the associated persons to provide a copy of their Statement of Claim to the customer in the underlying arbitration to ensure that the customer is aware that an expungement claim is pending regarding his or her prior dispute. This will also give the customer an opportunity to advise the arbitrators and parties (in writing or through participation in the expungement hearing) of their position on the expungement request, which may assist arbitrators in making the appropriate finding under Rule 2080.

In September 2017, we updated the guidance published on our website to discuss requests for expungement prior to the conclusion of the underlying arbitration. This section states that a broker may not file a request for expungement of customer dispute information arising from a customer arbitration claim until the underlying arbitration has concluded. If a broker files a request for expungement prior to the conclusion of the related customer

arbitration, FINRA will deny the forum as to the second expungement-only case. This procedure ensures that the underlying customer arbitration is resolved before any subsequent request to expunge customer dispute information from the underlying customer arbitration is considered.

Notice to Arbitrators and Parties on Expanded Expungement Guidance can be found on the Arbitration Special Procedures page of FINRA.org.

Neutral Workshop: In December 2013, FINRA conducted a neutral workshop that provided an overview of CRD and BrokerCheck, stressing the important role arbitrators play in safeguarding the integrity of the information in CRD in the expungement process. In May 2014, FINRA conducted a neutral workshop that provided expanded expungement guidance and an overview of the proposed new rule to address expungement of customer dispute information. In February 2015, FINRA filmed a neutral workshop addressing expungement, among other matters. In June 2019, FINRA filmed a neutral workshop that focused on the particular challenges of expungement hearings and provided practical tips for arbitrators when considering requests for expungement of customer dispute information. FINRA pre-records the workshops to allow neutrals to pause and playback the audio file. These and other recorded workshops provide an additional resource for information to neutrals and can be found on the **Neutral Workshop page** on FINRA.org.

The Neutral Corner: The December 2013 edition (Volume 4, 2013) of the arbitrator newsletter, *The Neutral Corner*, was devoted to the topic of expungement. The issue included an article emphasizing the procedural requirements in recommending expungement and another article discussing the limitations on the types of disclosures that may be expunged from CRD through arbitration. The September 2014 edition (Volume 3, 2014) included articles about the revised Award Information Sheet, the new Rule 2081 to address prohibited conditions relating to expungement of customer dispute information, and expanded expungement guidance for arbitrators to allow customers and their counsel to participate in the expungement hearing. The October 2015 edition (Volume 3, 2015) included information on recent court decisions on expungement. The December 2015 edition (Volume 4, 2015) included information on parties making second expungement requests after a previous denial. The March 2019 edition (Volume 1, 2019) noted that the Board approved proposed amendments to the Codes to codify the Notice to Arbitrators and Parties on Expanded Expungement Guidance and establish a minimum fee for expungement claims.

We also developed enhanced online training for arbitrators that expanded on and emphasized the points addressed in our expungement guidance.

The latest edition of ***The Neutral Corner***, along with previous issues, can be found on the Publications page on FINRA.org.

Online Arbitration Claim Filing Guide: FINRA revised the **Online Arbitration Claim Filing Guide** to include new information that asks claimants filing expungement claims to provide the occurrence number for the underlying disclosure and other registration information.

Award Information Sheet: To assist arbitrators with the updated expungement guidance, FINRA revised the Award Information Sheet.

We believe the above initiatives will help arbitrators safeguard the integrity of the information in CRD.

Short List Option to Reduce Extended List Appointments

Forum constituents want to select their own neutrals from the roster and thus have complained about the appointment of "extended list" arbitrators. Extended list arbitrators are not selected by the parties and may only be challenged for cause. (FINRA has virtually eliminated the appointment of extended list arbitrators in the initial appointment process.) FINRA has increased parties' options to reduce the likelihood of extended list appointments when an arbitrator withdraws or is no longer available, no ranked arbitrators remain on the parties' initial ranking lists and hearing dates are scheduled in a case. Under the "short list option," parties may stipulate to use a list of three arbitrators to select a replacement arbitrator. All parties must agree to use the short list option. Each side may strike one arbitrator's name from the list and may rank all remaining arbitrators' names in order of preference within a prescribed number of days.

If a hearing is scheduled within five calendar days of an arbitrator's withdrawal, removal, or unavailability, parties need to postpone the hearing to use the short list option. The postponement allows FINRA staff time to prescreen arbitrators for conflicts and to ensure they are available for scheduled hearing dates and to provide parties with time to review the list and strike and rank arbitrators. A postponement fee is charged in accordance with current FINRA rules. An additional fee is assessed for postponements granted within ten business days of the hearing date, also in accordance with current FINRA rules. Arbitrators may allocate the fees among the parties that agreed to the postponement. Arbitrators may also waive the fees.

As of May 2020, parties may complete the ranking and striking process for short lists by using the DR Portal.

More information, along with an FAQ, about the Short List Procedure can be found at the **Short List Option to Reduce Extended List Appointments** page of FINRA.org.

Voluntary Program for Large Cases

On July 2, 2012, FINRA implemented a voluntary program in all regional offices for large cases (i.e., cases with damages claims of at least $10 million exclusive of interest, costs and attorneys' fees). FINRA Dispute Resolution Services processes many cases that involve very substantial amounts in dispute. While the rules give the parties flexibility to agree on an ad hoc basis to vary from the procedures in the Codes, the large case program was introduced to provide a more formal approach to these cases.

Upon receiving written party agreement to use the program, the Regional Director and an experienced, specially trained Case Administrator will conduct an early administrative conference with counsel to develop a plan for the administration of the case. Areas to be discussed will include: arbitrator qualifications and the procedures for appointing arbitrators; the use of depositions and interrogatories; the form of the hearing record; and different hearing facilities (costs would be paid by the parties). Parties can use arbitrators from

outside of FINRA's roster or provide FINRA with criteria/qualifications to screen arbitrators on FINRA's roster. Parties may pay additional compensation to arbitrators above the standard FINRA honorarium. There is also a non-refundable administrative fee of $1,000 for each separately represented party to use the program. The large case program is available to eligible cases in each of our regional offices.

The program is targeted at cases involving damages claims of at least $10 million. However, any case can participate in the program where all parties agree and are represented by counsel.

A list of FAQ and the news release for the voluntary program for large cases are available on our website at the **Large Case Pilot – FAQ** page of FINRA.org

VIII. FINRA NEUTRALS

Arbitrator Disclosure

FINRA continually stresses to arbitrators the need to make complete and accurate disclosures. Below are recent measures we have taken to emphasize the importance of disclosing all information that may be relevant:

Arbitrator Disclosure Report Reviews

FINRA staff regularly conducts comprehensive reviews of arbitrators' disclosure reports to ensure accuracy and freshness of information.

- This review includes a search of legal databases such as PACER, detailed internet searches for new public information or publications, employment records, professional license records, etc.

- If new information is found, staff will contact the arbitrator for confirmation and add the information to the arbitrator's disclosure report.

Internet Searches

- We verify the accuracy of arbitrator disclosure by conducting internet searches of arbitrators prior to appointment to a case.

- If staff finds information during an internet search that is not disclosed in the arbitrator's disclosure report, staff contacts the arbitrator, confirms the validity of the information and adds the information to the neutral's disclosure report.

Last Affirmation Dates

- FINRA displays the date that arbitrators last affirmed the accuracy of their disclosure reports at the top of the disclosure report documents.

- Arbitrators are advised to regularly review and affirm the accuracy of their disclosures on the DR Portal, as parties may consider the last affirmation date as a factor when selecting arbitrators for their cases.

- Arbitrators can confirm the accuracy of their disclosures in two ways:
    - Submitting an update through the DR Portal;
    - Submitting an Oath of Arbitrator when assigned to a case.

Attorney Information

- Disclosure reports feature the names of party representatives and the city and state in which the representative practices on each of the arbitrator's active cases.

- This feature helps to alert parties to potential conflicts based on legal representation.

More information on **Arbitrator Disclosure** can be found on the Information for Arbitrators page at FINRA.org.

Arbitrator Recruitment

A primary goal of FINRA's arbitrator recruitment program is to identify and train a qualified pool of potential arbitrators from which parties can choose to hear their disputes. The strategic goal has been to continue to shift the balance of the arbitrator pool to include more public arbitrators and a more diverse roster nationwide. FINRA has implemented an aggressive recruitment campaign to seek individuals from diverse backgrounds from across different industries to serve as arbitrators. Ongoing recruitment initiatives thus far have included more than 100 women and minority organizations nationwide to source and recruit all types of people through on-site events, targeted recruiting advertisement and direct marketing campaigns.

To help maximize our resources and opportunities further, we leveraged our staff talent in the regions to assist with recruitment efforts, particularly in reaching women-focused groups, LGBT communities and other untapped diverse organizations. We also hired an additional full-time national recruiter in 2015.

FINRA worked to recruit arbitrators with the following professional organizations in 2019:

- Alpha Kappa Alpha Sorority, Delta Sigma Theta Sorority, Junior League, Kappa Alpha Psi Fraternity, the LGBT Bar Association (Lavender Law), the National Association of Black Accountants, Inc., National Urban League, the Risk Management Society, the Society for Human Resource Management (SHRM), Student Affairs Administrators in Higher Education (NASPA), and Women's Business Enterprises

In 2019, FINRA hosted networking events with the following organizations:

- Asian Pacific American Bar Association – DC Chapter, Asian Pacific American Bar Association – LA Chapter, Asian Pacific American Women Lawyers Alliance, Black

Women Lawyers Association of Los Angeles, Cuban American Bar Association, Filipino American Lawyers Association of Washington DC, Gwen S. Cherry Black Women Lawyers Association, Haitian Lawyers Association, Inc., Hellenic Bar Association, Hispanic Bar Association of D.C., Hispanic Bar Association of NYC, LGBT Bar Association and Foundation of Greater New York (LeGaL), Metropolitan Black Bar Association, Muslim Bar Association of NY – MuBANY, Network of Bar Leaders, and the Thai American Bar Association, Caribbean Bar Association

In 2020, we plan to hold attorney-focused arbitrator recruitment events in Columbia, SC; Denver, CO; Jacksonville, FL; and Minneapolis, MN.

We are continuously enhancing the diversity of our arbitrator roster. In 2019, we saw increases in the number of women on the roster. We also saw increases in the number of African-American and Asian arbitrators. Of the new arbitrators added to the roster in 2019, 39% were women, 19% were African-American and 3% were Asian.

We are also enhancing the diversity of our mediator roster. Of mediators (who may also be arbitrators) polled in 2019, 24% were women, 6% African-American, 4% Hispanic or Latino, 2% Asian, and 4% were LGBT.

To learn more about FINRA's efforts to diversify our arbitrator and mediator rosters visit **Our Commitment to Achieving Arbitrator and Mediator Diversity at FINRA** at FINRA.org

Finally, to become more effective in how we communicate our message, we have begun using social media to recruit arbitrators. All FINRA Dispute Resolution Services Twitter updates can be found under FINRA's Twitter handle, **@FINRA**. We also released our first formal recruitment video on several social media platforms including Vimeo, LinkedIn and YouTube in December 2016: **https://vimeo.com/188349814**.

Arbitrator Application and Approval

Individuals interested in becoming an arbitrator can apply to our roster using the online arbitrator application available in the **Become an Arbitrator** section of our website. Applicants can complete the arbitrator application and submit it electronically along with a completed Consent to Background Search and Investigation Form and Social Security Number Verification Form. FINRA conducts a review of applications and works with applicants to ensure their submissions are complete before forwarding them to a subcommittee of the NAMC for final approval. FINRA processes applications and notifies applicants within 120 days from the date of receipt.

In 2019 we received 1,041 applications, exceeding our goal of 750 applications. The average time for application process completion was 96 days. As of July 15, 2020, there were 3,765 public arbitrators on our roster.

Arbitrator Training

Through 2018, arbitrator applicants were required to complete the Basic Arbitrator Training program, consisting of: (1) online basic training; (2) online expungement training; and (3) classroom training. After successfully completing the online basic and expungement

courses, candidates were required to attend the classroom training at one of our regional offices or by live video. FINRA offered live video training in an interactive WebEx format to allow candidates to participate remotely. In 2018, on average, arbitrators completed this training in 91 days.

As of February 2019, in an effort to streamline training, FINRA discontinued the live classroom-training requirement. Instead, we now offer voluntary live Arbitrator Orientation Sessions where new arbitrators can ask questions and learn more about the forum in an informal setting. We are continuing to expand and improve our online training offerings.

To be considered for the chairperson roster, arbitrators must complete FINRA's online chairperson training and satisfy the case service requirement. FINRA staff has discretion to select arbitrators to serve on the chairperson roster from among those arbitrators who have completed the online chairperson training and: (1) have a law degree, are a member of a bar of at least one jurisdiction, and served as an arbitrator through award in at least one arbitration administered by a self-regulatory organization; or (2) if not an attorney, served as an arbitrator through award in at least three arbitrations administered by a self-regulatory organization (Customer Code Rule 12400(c) and Industry Code Rule 13400(c)).

In addition to the required trainings, FINRA offers advanced, subject-specific courses.

For more information on Basic and Advanced Arbitrator Training visit the **Arbitrator Training** page at FINRA.org

IX. FINRA DISPUTE RESOLUTION SERVICES TECHNOLOGY INITIATIVES

Online Portals

Portal for Parties. Use of the Portal is mandatory for all parties, excluding pro se investors. This rule applies to all cases filed on or after April 3, 2017. Parties using the Portal can sign into a secure website and perform many functions online, including:

- filing a claim;
- receiving service of a claim;
- submitting an answer to a received claim;
- submitting additional case documents;
- viewing the status of a case;
- viewing case documents;
- striking and ranking arbitrators online;
- viewing and downloading disclosure reports of prospective arbitrators;
- scheduling hearing dates online; and
- paying invoiced fees.

Portal for Neutrals. Neutrals are not required to use the Portal on a mandatory basis, but arbitrators and mediators must register in the Portal to take advantage of the numerous functions it provides, such as:

- viewing and printing their disclosure reports;

- viewing and updating their personal profiles and disclosures;
- accessing information about their assigned cases, including upcoming hearings and payment information;
- viewing case documents;
- submitting documents;
- scheduling hearing dates;
- reviewing and signing awards; and
- viewing how often their names have appeared on arbitrator ranking lists sent to parties, and how often they are ranked or struck on those lists.

FINRA Dispute Resolution Services Website

The FINRA Dispute Resolution Services website, **https://www.finra.org/arbitration-mediation**, provides various resources for parties and neutrals regarding FINRA's arbitration and mediation processes. On the website users can find, among other things: an overview of arbitration and mediation; information on how to file a claim; forms that parties and arbitrators need in the arbitration process; arbitrator and mediator applications; the Codes; and rule filing information.

Arbitration Awards Online

FINRA's Arbitration Awards Online database is available without charge on FINRA's website at **https://www.finra.org/arbitration-mediation/arbitration-awards**. Through the database, users can access FINRA arbitration awards from February 1989 through the present.

In addition, users can access all the New York Stock Exchange (NYSE) arbitration awards, as well as the awards of all arbitration programs absorbed over the years by FINRA (which include the American Stock Exchange, Chicago Board Options Exchange, International Stock Exchange, Philadelphia Stock Exchange, and Municipal Securities Rulemaking Board) and NYSE (which includes Pacific Exchange/NYSE ARCA).

The database provides users with access to awards and the ability to search for awards by using multiple criteria, such as by case number, keywords within awards, arbitrator names, date ranges set by the user, and any combination of these features. FINRA now includes in customer awards information about the panel selection method and panel composition.

Videoconferencing

All four of FINRA's regional office locations have videoconferencing capabilities. With the consent of all parties or with the permission of the arbitration panel, parties or witnesses may appear at hearings by videoconference for hearings held in one of the regional office locations. There is no additional cost to use the videoconferencing equipment at FINRA. Parties are encouraged to notify their Case Administrator at least 30 days prior to the hearing to request videoconferencing services. All videoconferencing requests are honored in the order they are received.

X. MEDIATION

Mediation remains an important service that FINRA offers. Since the program's inception in 1995, FINRA's mediation staff has administered thousands of cases involving a wide variety of securities disputes with over 80 percent resulting in settlement between the parties.

Parties interested in mediation can fill out an online **Request for Mediation Form** which is located on the Initiate a Mediation page at **https://www.finra.org/arbitration-mediation/initiate-mediation**. Parties involved in current arbitration cases can also indicate their interest in mediation by checking the box on the Party Case Submission Form in the DR Portal. Both methods relay a message to mediation staff, who will follow-up with other parties regarding available mediation options.

COVID-19 Reduced Fee Mediation Program

FINRA is offering parties the remote use of mediation through October 2020 at significantly reduced fees. More than 100 mediators have agreed to participate in the program, which features the following benefits:

- Parties will receive a random list of 10 national mediators along with their Mediator Disclosures for their consideration and ranking;
- The mediator payment for his/her service is $100 an hour split by the parties; and
- FINRA waives all mediation filing fees and administrative fees

Additionally, FINRA Dispute Resolution Services offers virtual hearing services (via Zoom and teleconference) to parties in all cases by joint agreement of parties and mediator. These services provide high-quality, secure, user-friendly options for conducting video and telephonic mediation sessions and sharing documents remotely. Staff is available to schedule virtual hearings and provide technical support.

Interested parties should contact the Mediation Administrator for their region.

Mediation Program for Small Arbitration Claims

Since February 2013, FINRA has offered reduced fee and pro bono telephonic mediation to parties in simplified cases. Under the program, mediators serve on a pro bono basis on cases alleging $25,000 or less in damages. We have also offered significantly reduced fee mediation at $50 per hour on cases alleging damages between $25,000.01 and $50,000. The program benefits forum users by: (1) increasing the number of cases that settle and giving parties more control over the results of their cases; (2) reducing travel and preparation costs; (3) providing an alternative for senior, seriously ill, and physically challenged parties who may find traveling to and attending an in-person mediation especially difficult; and (4) offering parties in small cases an efficient and cost-effective option to meet their needs within our forum.

Separately, the program provides newer mediators with an opportunity to demonstrate their mediation skills. Staff has processed hundreds of requests to mediate through the Mediation Program for Small Arbitration Claims with parties settling over 80% of cases mediated. FINRA continues to communicate the opportunity for parties to mediate through this

program to all eligible cases, and highlights the benefits of this affordable mediation option for small claims.

For more information on FINRA's Mediation Program visit the **Learn About Mediation** page at FINRA.org.

WOMEN IN THE PROFESSION- TELL ME I CAN'T

Sara Hanley, Esq.[1]

I. Introduction

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

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

II. We Know the Problems All Too Well

A. Implicit Bias

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

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

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

[4] *Id.*

[5] *Id.*

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

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

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

B. Why so Few Women?

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

The lack of female partners and equity partners may stem from a lack of women in the workforce pipeline because historically there were fewer female attorneys or maybe it is due to a continuing failure to recognize and promote women candidates.[16] Alternatively, it could be that fewer women

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

[8] *Id.*

[9] *Id.* at 8.

[10] *Id.* at 10.

[11] *Id.*

[12] *Id.*

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

[14] *Id.*

[15] *Id.*

[16] *Id.*

are willing to take on greater responsibilities because male partners are paid on average 27% more than female partners.[17] The good news is that these statistics are bound to change. Overall, the number of qualified women is growing in comparison to men.[18] In 2016, for the first time ever in the U.S., women made up the majority of law students.[19] Today, in the U.S., women make up 51.3 percent of all law students.[20] Achieving gender neutrality in the practice of law is more than just a moral obligation. Any law firm that wishes to remain competitive in the marketplace cannot afford to leave 50% of its talent at the door.[21]

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

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

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

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

[19] *Id.*

[20] *Id.*

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

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

[23] *Id.*

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

[25] *Id.*

[26] *Id.*

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

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

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

D. Sexual Harassment Remains Problematic

Without question the one area in which women's experience in the profession is drastically different from their male counterparts' experience is the much greater extent to which women experience sexual harassment.[34] It is important to understand the common workplace abuses, including non-sexual abusive behavior, and to introduce appropriate protections. According to the ABA, thirty percent or more female lawyers have suffered some form of sexual harassment and bullying in the workplace, and at law firms that percentage is likely greater.[35] The persistence of sex-based harassment in the legal profession has profound impacts on the physical and emotional well-being of female lawyers resulting in the decreased job satisfaction and disillusionment with the legal profession.[36]

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

[29] *Id.* at 7.

[30] *Id.*

[31] *Id.* at 7-8.

[32] *Id.* at 8.

[33] *Id.*

[34] *Id*.

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

[36] Aditi Kumar, *Professional Ethics in the #MeToo Era: A Growing Awareness of Sexual Harassment*, A.B.A. EMP. BENEFITS COMMITTEE NEWSL. (March 4, 2019),

The Equal Employment Opportunity Commission (EEOC) states that "harassment not involving sexual activity or language may also give rise to Title VII liability…if it is 'sufficiently patterned or pervasive' and directed at employees because of their sex," and that the employer may be vicariously liable for such harassment.[37] The laws against misconduct apply to supervisors, co-workers, peers, clients, judges, professors, students and vendors.[38] Abusive behaviors are defined to include demeaning, condescending or sexualized comments or jokes.[39] Increasingly, sex-based harassment in the workplace has become more nuanced and subtle and is demonstrated in ways such as interruptions or dismissive remarks, comments on appearance, or indirect intimidation.[40] The actions that constitute legally actionable harassment are often situational and fact determinative.[41] To reach the goal of preventing and eliminating sex-based harassment from the legal profession, firms must enact and enforce uniform policies that develop a zero tolerance for harassment.[42] The ABA recently amended Model Rule of Professional Conduct 8.4(g) to state that "professional misconduct" includes any "[c]onduct that the lawyer knows or reasonably should know is harassment or discrimination on the basis of …sex,…sexual orientation, gender identity, [or] marital status…in conduct related to the practice of law."[43]

Lawyers and law firms should be aware of the inconspicuous ways sex-based harassment often manifests and becomes normalized.[44] Gender bullying and inappropriate professional behavior is so pervasive in the workplace that is often overlooked, but it is a precursor to actionable forms of sex-based harassment that should not be ignored.[45] A significant number of female attorneys report that opposing counsel, judges, and other court officials mistake them to be secretaries or paralegals.[46] Similarly, there are many unconscious behaviors that perpetuate stereotypes and sex-based treatment that individuals fail to recognize with their own behaviors and the culture of their professional organizations.[47] It is imperative that law firm and legal organization leaders implement a common sense approach and enforceable policies that allow women to report sexual harassment, protect them from retaliation, and punish the perpetrator of the misconduct.

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https://www.americanbar.org/groups/labor_law/publications/ebc_news_archive/spring-2019-issue/professional-ethics-in-metoo-era/ (last visited Sept. 9, 2020).

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

[38] *Id.*

[39] *Id.*

[40] *Id.*

[41] *Id.* at 17.

[42] *Id.*

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

[44] *Id.* at 17-18.

[45] *Id*. at 17.

[46] *Id.* at 16.

[47] *Id*. at 17-18.

Inappropriate sex-based workplace conduct is harmful to employees, and it tarnishes the legal professional as a whole; yet, unfortunately, it has long been generally socially acceptable. The positive news is that cultural norms of sexism and sex-based harassment are slowly dying, and it is no longer as much of an acceptable societal convention to harass women in the workplace. It is time for the legal profession to send a strong message, as we have seen in other industries, that sexual harassment will not be tolerated.

E. Assignment Allocations and Family Responsibilities

Law firms, just like any other workplace, have both high profile assignments, or "glamour work," that is career enhancing and "office housework," or low-profile assignments, that are beneficial to the organization but not to the individual's career.[48] Research shows that women do more "office housework" than men, such as administrative tasks and providing emotional support.[49] The overallocation of office work and under allocation of glamour work to women across the legal profession is a key reason why leadership in the legal field is still male dominated.[50] Women often report less access to desirable assignments than white men.[51] In law firms that are often driven by billable hours, when a female lawyer becomes overburdened with office housework, it decreases the amount of time she can dedicate to billable hours, which in turn hurts her compensation and her career.[52]

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

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

[49] *Id.*

[50] *Id.*

[51] *Id.*

[52] *Id.*

[53] *Id.*

[54] *Id.*

[55] *Id.*

[56] *Id.*

As securities attorney Jenice Malecki wrote, "in the legal profession where billable hours and client interaction are vastly important to promotions and success, equal work at home is a necessary component for women to achieve top leadership positions and equal pay opportunities."[57] She further concludes that arguments have been made that women leave the workforce to rear children, but we need to ask ourselves whether they leave because they earn less than their spouse.[58] When it comes to law firm compensation, many female lawyers believe that the compensation policies are "rigged" against them.[59] Families are often forced to make financial decisions that are not always best for the individual professional involved, but if equal work resulted in equal pay for men and women, at least some financial decision making would be based on more even grounds.

III. Let's Focus on the Solutions

A. Grit and Growth Mindset

As a profession, what can we do to really move the needle on equalizing the workplace experiences of men and women in the legal profession? Historically, there have been relatively few studies to identify the obstacles that contribute to the gender gap in the leadership levels of the legal profession.[60] Until recently, there has been little known about what common characteristics the women who make it to equity and non-equity positions in the top ranks of law firms have in common.[61] In 2012, a crucial study undertook this vital research.[62] The results of the research identified two main significant traits among highly successful female attorneys: grit and growth mindset.[63] The best news, is that these are factors which female lawyers control.[64] Grit is defined as "perseverance and passion for long-term goals."[65] "Growth mindset" is defined as "the belief that one's most basic abilities can be developed through dedication and hard work-brains and talent are just the starting point."[66] The growth mindset gives rise to a dedication to learning and deep resilience that is necessary for unlimited accomplishment.[67] Grit paired with a

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

[58] *Id.*

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

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

[61] *Id.*

[62] *Id.*

[63] *Id.*

[64] *Id.*

[65] *Id.*

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

[67] *Id.*

growth mindset were found by researchers to be the keys to female attorneys' success.[68] These tools aid highly-successful female attorneys in handling and ultimately overcoming difficult situations.[69]

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

When it comes to mindset, individuals with a fixed mindset believe that their strengths are predetermined, whereas people with a growth mindset see their abilities as adaptable and capable of growth through determination and dedication.[74] A recent study of female attorneys in AmLaw 200 firms evidenced a strong, statistically important relationship between grit and success for women in BigLaw.[75] The research implies that grit is a precursor to success rather than an outcome of it.[76] Researchers have also determined that many affluent female attorneys exhibit growth mindset characteristics and depend greatly on these skills to navigate adversity and the often times overwhelming demands in the practice of law.[77] The most advantageous benefit of this new research is that the grit and growth mindset is in the control of the individual.[78] These traits, which can at least partially be learned, lead to the continued success of more female attorneys.

The grit and growth mindset is a crucial trait for both seasoned professionals and recent law school graduates.[79] The traits attributed to grit are: diligence; flexibility and adaptability regarding unforeseen, ambiguous or changing circumstances; resilience after a set-back; passion for the work; ability to regulate emotions and demonstrate self-control; set goals and make a plan to meet

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

[69] *Id.*

[70] *Id.*

[71] *Id.*

[72] *Id.*

[73] *Id.*

[74] *Id.*

[75] *Id.*

[76] *Id.*

[77] *Id.*

[78] *Id.*

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

them; and taking ownership.[80] Growth mindset traits include enjoying overcoming challenges; having an internalized commitment to developing towards excellence; having a strong work ethic and putting forth best effort; positivity; and showing initiative.[81] These traits are critical to success for female lawyers, whether they are in their first year of practice or have been practicing law for decades.[82] The research developed as part of the grit and growth project applies commonly to a broad range of legal settings, including success in law firms of all sizes, solo practitioners, government, not-for-profits and in-house positions.[83] Ultimately, the findings from the research of the ABA Commission on Women in the Profession determined that demonstrations of grit and growth mindset have a strong impact on success of female lawyers across all practice settings.[84]

It has been argued that it's not smarts, talent, looks, luck or chance that separates the risers from the fallers –it's grit.[85] The modern term "grit" was coined in 2013 by Angela Duckworth, a psychology professor at the University of Pennsylvania.[86] Duckworth described grit as the "quality of being able to sustain your passions, and also work really hard at them, over really disappointingly long periods of time."[87] She taught that individuals with grit are people who can overcome stress and use failure as a means to achieve their ultimate goals.[88] Grit has also been described as an "indomitable spirit."[89] Grit is resilience and going after what you want with everything you've got.[90] Grit means striving for progress and never yielding in pursuit of your passions, whether or not the legal arena is fair and welcoming to female attorneys, which most conclude it is not. Sometimes to make progress you have to get comfortable in the uncomfortable and successful female lawyers know this all too well.

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[80] *Id.* at 52.
[81] *Id.*

[82] *Id.* at 49.

[83] *Id.* at 50.

[84] *Id.*

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

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

[87] Hamilton, *supra* note 87.

[88] *Id.*

[89] *Id.*

[90] *Id.*

B. Check Yourself

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

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

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

IV. What Legal Organizations Can do to Help

As professionals and members of professional organizations, we must encourage underrepresented attorneys to be promoted and to have the opportunities to contribute towards

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

[92] Malecki, *supra* note 57.

[93] *Id.*

[94] *Id.*

[95] *Id.*

[96] *Id.*

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

[98] Malecki, *supra* note 57.

[99] *Id.*

an upstanding, diverse, fair, and efficient legal system.[100] Every organization has a culture defined by its policies, practices, expectations, unwritten rules, implicit and explicit biases, and professional goals. This culture can have either a positive or negative consequence for gender parity. If we want our legal organizations to thrive and improve, then we need some baseline protections in place to support members who may experience harassment or sexual harassment. There must be a zero-tolerance policy. Decorum and respect towards the other members of the organization should be non-negotiable. Gender neutrality in the practice of law and in professional organizations should be the norm and not the exception.

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

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

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

V. Conclusion

The increasing number of diversity and women's initiatives are encouraging, but we still have a ways to go to change legal culture. Double standards regarding behavioral expectations, lack of advancement opportunities and lack of recognition remain pervasive. Making meaningful advancements towards gender parity in the legal profession is no small feat. The impediments that female attorneys face have nothing to do with their qualifications, talent, or ambition, but are created by implicit bias, stereotypes and sexual harassment, all of which are unacceptably pervasive in the legal profession.[101] Simply due to their gender, women endure demeaning comments, are deprived opportunities, are overlooked for advancement, and are often excluded.

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[100] *Id.*

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

Until laws and societal norms change, the only control we have as women and men who care about this issue is to change our own behavior. As women, we can change our outlooks, expectations, approaches, and work hard every day to level the playing field. Most importantly, we must speak up for ourselves and others when we are presented with unacceptable behaviors. Silence is consent and there will be no positive change if issues are not confronted. Gender parity is advancing in the legal profession, but traditions, cultures and behaviors only change when there is a strong commitment to making the change and competent actions create a culture of respect and accountability.

MINORITIES AND WOMEN IN THE SECURITIES INDUSTRY: THE DISPROPORTIONATE IMPACT OF SECURITIES FRAUD EXPLOITATION

People of color and women have been greatly impacted whether it is as victims of fraud or underrepresented in the field as a career prospect. During an age of Black Lives Matter Protests and women speaking out against gender discrimination, the Securities sector has a great task on their hands to create prevention programs for fraud in these communities as well as revitalize inclusive practices in the employment process. It is important to address the privilege of employees or investors that may be immune or ignorant to the issues that plague the world they exist in. Creating a community that encourages employment in official board roles as well ensuring an informative environment through which individuals can protect themselves from fraud is critical for vulnerable populations.

The securities industry is not known for its diversity. It is not every day we have a “Lauren Simmons” come to the forefront of our attention, challenging the status quo of what the securities field looks like. Lauren Simmons became the youngest trader at the New York Stock Exchange at just 22 years old. She was the second black female trader of her time. It wasn't until 1952 that the first African American securities firm was founded with an NASD license. Subsequently, it wasn't until 1960 that the first Wall Street African American securities firm was opened by Phil Jenkins and Harry Wright. It took until the early 2000s for an African American to be titled CEO at a major brokerage firm namely, Stanley O’Neal. The United States Equal Employment Opportunity Commission from 2006 references that African Americans make up only 7% of the banking Subsector as well as only 4.4% of the Securities subsector. It's quite evident that the journey towards inclusivity within the Securities sector has been slow and challenging for various populations.

Similarly, women, of any race, constitute 46.9% of the Finance and Securities Labor force according to the US Bureau of Statistics in 2018, but only make up 19.4% of the senior-level positions. Geraldine Weiss was a quintessential example of a woman trying to push past the restrictive hierarchy in place within the securities industry. No investment firm wanted to hire her in a position above secretary, although her qualifications were much greater. Immediately, once companies saw her feminine name, they categorized her caliber into a lower position which hindered her career growth. Eventually, she went by G.Weiss, so her identity remained ambiguous, which allowed her financial strategies to speak for itself, achieving above-average returns. That is just the tip of the iceberg. Muriel Siebert, Abigail Johnson, Abby Joseph Cohen, Lubna Olayan, and so many more women’s stories take an incredible amount of effort to come to the forefront of their field merely because of their gender. It is quite fascinating to imagine the strength, power, and potential of the securities industry if it looked primarily at merit and less in regards to race and gender.

An audit regarding the Representation of Minorities and Women in the SEC’s Workforce run by the Office of Inspector General(2013-2014), reveals a trend in which women and minorities received fewer cash awards or bonuses, as well as were exposed to lower performance

management and recognition scores. The results of that audit suggested that various diversity initiatives within the SEC have not taken the appropriate steps or research to truly understand the barriers that currently operate in the SEC's workplace to exclude minorities and women. The Office of Equal Employment Opportunity did not complete a thorough analysis of the inner workings that impose restrictions on equal opportunity. The Office of the Inspector General accepted that women were underrepresented at higher levels at the SEC. In addition, the rate of complaints filed in regards to equal opportunity was statistically greater by African American individuals or women. The positive aspect of this audit was a memorandum attached to the bottom indicating all the aspects of this topic that require change as well as the management response. The management was committed to data and tables of the following year as required by the Management Directive and compliance with Section 342 of the Dodd-Frank Act in order to correct hurdles to equal opportunities.

In regards to the Latino/a community, they are also blatantly underrepresented in leadership roles within the securities and financial services industry. According to the 2003-2004 Corporate Governance Study, Latinos only served on boards within 166 of 1000 Fortune 1000 Companies. Furthermore, according to the study, 15% of the United States Population is Latino/a but only 4.7% of that population work in the securities industry. The United States Equal Employment Opportunity Commission in 2006 explained that Latino officials at its highest constitute 5.1% of the Central Banking subsector while only making up 2.9% of the Securities subsector. The chair of the board of directors of the New American Alliance, Ana Maria Fernandez Har, provided an array of guidelines that would enhance Latino participation which includes actively expanding the diversity within corporate boards, launching inclusive teams, broadening hiring protocol and having current leaders emphasize the value of corporate diversity.

There are some regulations that exist within the Securities industry that disproportionately impact people of color, specifically African Americans and Latinos. The Securities Exchange Act of 1934 requires that the SEC suspend privileges, dismiss, revoke registrations, or order severe consequences for individuals that have been sentenced for misdemeanors or felonies. This is determined through fingerprints that are submitted by potential and current employees regularly. This practice can arguably be in violation of Title VII which protects employers from employment practices that unfairly impact a particular population. For example, fingerprinting specifically impacts African Americans and Latinos as they are more likely to have a criminal record due to the nature of our criminal justice enforcement practices. There are proposals for narrowing the range of the fingerprinting rule to encompass criminal records in regards to the business necessity. Incarceration negatively impacts African and Hispanic communities about 6.5 and 2.5 times greater respectively than white individuals.

The United States Equal Employment Opportunity Commission from 2006 quite explicitly states that out of the thousands of jobs that exist within the various sectors of the financial services industry, participation of women and minorities linger anywhere between 47.3% and 0.1% in top-level roles namely officers as well as managers. The Securities industry consistently has the lowest percentage of inclusion when compared to the other subsectors (banking, insurance, funds, central banking) regardless of the roles or races being discussed. This quite evidently puts

into perspective how complex the path may be to the securities industry for a person of color or woman, as well as even more relevant for those that identify as LGBTQA+.

While from an employment perspective, encouraging diversity is crucial, it seems that even from an investor standpoint people of color are more likely victims of securities fraud than white individuals. According to the Federal Trade Commission, African American and Latino populations under-report fraud, despite the statistics revealing that securities fraud is more likely to impact these communities. These populations and demographics are often impacted by fraud targeting their income and debt. Misleading work from home offers, affinity fraud, pyramid schemes, business ventures to make use of people's desperation to work, debt relief, mortgage relief, and other schemes that profit off of an individual's financial insecurities. In addition, a lack of sound financial backing could mean that those aforementioned vulnerable populations would be unable to take a legal case forward. In a report to Congress by the Federal Trade Commission from 2016, it indicated that about 10.8% of the United States population had been defrauded, which equates to over 25 million people. The purpose of this report was to design various strategies that would reduce fraud in African American and Latino communities and ensure preventative methods. These methods must motivate financial regulatory institutions to closely understand the hurdles that make African American and Latinos more susceptible to fraud, as well as begin reversing that unfortunate reality.

Malecki Law is dedicated to protecting the justice and equality of vulnerable individuals that are negatively impacted by fraud. The firm will continue to strive for favorable results for individuals that are disproportionately impacted by schemes and fraudulent financial practices. Ensuring a vocal, progressive and inclusive workspace is a crucial priority for us as a team. For over two decades, Malecki Law has upheld a fair and equal workplace as well as committed itself to ensuring favorable outcomes for ALL of our clients. We stand by and inclusive measures, fraud prevention programs or informative workshops that are compatible with the values of our firm for the purpose of protecting both employees and fraud victims of all backgrounds.

WHEN SECURITIES CLAIMS COLLIDE WITH THE BANKRUPTCY CODE

Randall A. Pulman & Amber Fly Pulman

FACT PATTERN

Plaintiff's lawyer, PIABA Pete, has had a great day. The case of his career has just walked in the door. This is the case PIABA Pete has been waiting on so that he can finally retire.

Lily White, an elderly retired schoolteacher, is terrified. Her husband, a blue-collar worker, died in a terrible workplace accident a couple of years back. The Whites had always lived a frugal life, and between their savings, life insurance, the retirement accounts, and the settlement from her husband's wrongful death case, Lily White found herself with a $10,000,000.00 estate. She had no idea what to do, but as luck would have it, a financial advisor, Burt Blackheart, volunteered his services. She knew Burt from church as a long-lost friend who previously did great work for her cousin. Burt came to the funeral for Lily's husband and, after an appropriate amount of time, asked her to dinner "just to get her out of the house." At dinner, Lily confided in Burt that she did not know what to do with all the money deposited into her bank accounts.

Shortly after the dinner meeting, Lily opened an account with Burt's firm, Oakmont Financial Planners. Oakmont Financial Planners was a one-stop shop. Burt could sell her insurance, stocks, and bonds or simply give her advice. For special, high-net-worth individuals like Lily, Burt could offer guaranteed high yield investments in selective hedge funds, real estate projects, and off-shore bank CDs that all paid a guaranteed 8% a year. The best part was that Lily would not have to pay a commission. Lily, for the first time in her life, felt special.

Things appeared to go splendidly. Burt invested her money, and since all she needed was $5,000.00 a month to live like a queen, the rest of the money could compound and grow. She could make contributions to charity, send her grandchildren to college, and leave a considerable sum of money to her church. Lily received mail from Oakmont Financial Planners all the time, but Burt told her not to bother to open or worry about it as he was watching everything very carefully. Burt repeatedly told Lily she should just enjoy herself.

Suddenly, about three months ago, the monthly checks stopped. After Lily inquired, Burt came by her home and explained that there had been a problem with the accounting department. Burt assured Lily that everything was fine, and the checks would start coming again on the first of the month. The check did not come as promised, and Lily's daughter suggested that Lily needed to see a lawyer. Lily did not think so, but she did see on the news that morning something about an SEC raid on a hedge fund that sounded familiar. She remembered that she had received some mail from the Super-Mega-Uber Hedge Fund ("Super-Mega") located in Antigua.

After she broke down in tears in PIABA Pete's office, Lily signed a fee agreement. PIABA Pete had to make a difference in Lily's life. He would find her justice and get back her money.

After sorting through three years of statements, it became apparent to PIABA Pete that Burt invested all the money in illiquid partnerships and offshore bank accounts, and now Super- Mega is in a SEC receivership. There was a reference in the sales material to an E&O insurance policy. PIABA Pete suspects that Oakmont put most of its customers in Super-Mega. After some investigation, PIABA Pete also figured out that all the investments paid Oakmont Financial

Planners a 10% commission, and that Burt had purchased a $1,000,000.00 yacht to go with his newly remodeled $5,000,000.00 beachside residence and homestead located in Texas.

PIABA Pete visits with his long-time partners and considers whether to pursue involuntary bankruptcy for Super-Mega or leave it in an SEC Receivership. The decision is made not to challenge the SEC Receivership. How much difference could it make?

PIABA Pete takes the obvious path—he files a receivership claim in the Super-Mega SEC Receivership proceedings on behalf of Lily and files a FINRA arbitration against Burt and Oakmont Financial Planners. The claims made are unsuitability and breach of fiduciary duty. Blue Sky Law, '33 Act and '34 Act claims are made, but PIABA Pete doesn't think that he can identify a specific misrepresentation or omission. Good news, the receiver confirms that Oakmont Financial Planners did carry a $10,000,000.00 wasting E&O policy. Lily is going to be okay, and Pete will make a handsome, life-changing fee. When this one is over in a few months, PIABA Pete will be able to retire. At least it seems that way.

1) FEDERAL BANKRUPTCY TRUSTEES V. SEC RECEIVERS: TRUSTEES CAN'T TAKE YOUR THIRD-PARTY CLAIMS, BUT RECEIVERS CAN—IN SOME CIRCUITS, AT LEAST.

Applicable statutory provision – Fed. R. Civ. P. 66:

> [T]he practice in administering an estate by a receiver or a similar court-appointed officer must accord with the historical practice in federal courts or with a local rule.

Applicable statutory provision – 28 U.S.C. § 959(b):

> (b) Except as provided in section 1166 of title 11, a trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.

Applicable statutory provision – 11 U.S.C. § 1104:

> (a) At any time after the commencement of the case but before confirmation of plan . . . the court shall order the appointment of a trustee—
>
> > (1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of debtor;
> >
> > (2) if such appointment is in the interest of creditors[.]

Analysis

There are several key distinctions between a SEC receiver and a bankruptcy trustee. An SEC Receiver is appointed on a case-by-case basis often to preserve status quo or prevent diversion and waste of assets. *SEC v. Current Financial Services Inc*., 783 F.Supp. 1441, 1443 (D.C. 1992). Unlike a bankruptcy trustee, an SEC receiver is not bound by the bankruptcy code. Unlike an SEC receiver, a chapter 11 trustee has the same duties as a debtor-in-possession, and payment to creditors must comply with the absolute priority rule. Therefore, victims of securities fraud may obtain higher priority in a receivership case than they would under bankruptcy.

Although receivers typically do not have the same caliber of experience in liquidating a company as a bankruptcy trustee, claims by creditors against third party defendants are not property of the bankruptcy estate and therefore cannot be pursued by the trustee. *In re S.I. Acquisition, Inc.* 817 F.2d 1142, 1150 (5th Cir. 1987). Specifically, a bankruptcy trustee may only bring forth derivative claims for causes of action such as alter-ego, fraudulent conveyances, and breach of contract. Courts are divided on whether a receiver can bring forth and settle claims made by creditors of the receivership estate.

Within the Fifth and Tenth circuits, a receiver may pursue and settle creditor claims with third-party defendants because the creditor claims are related to the estate and ultimately increase the liability of the receivership estate. *Zacarias v. Stanford Int'l Bank, Ltd.*, 945 F.3d 883 (5th Cir. 2019); *Sec. & Exch. Comm'n v. Stanford Int'l Bank, Ltd.,* 927 F.3d 830 (5th Cir. 2019); *SEC v. DeYoung*, 850 F.3d 1172 (10th Cir. 2017). The First, Second, Seventh, and Eleventh circuits, on the other hand, hold that a receiver does not have standing to bring claims against third party defendants. *Isaiah v. JPMorgan Chase Bank, N.A.*, 960 F.3d 1296 (11th Cir. 2020); *Fleming v. Lind-Waldock & Co.*, 922 F.2d 20, 25 (1st Cir. 1990) ("Since 1935 it has been well settled that 'the plaintiff in his capacity of receiver has no greater rights or powers than the corporation itself would have.'") (*quoting McCandless v. Furlaud*, 296 U.S. 140, 148 (1935)); *Eberhard v. Marcu*, 530 F.3d 122, 132 (2d Cir. 2008) ("A receiver may commence lawsuits, but 'stands in the shoes of the corporation and can assert only those claims which the corporation could have asserted.'") (*quoting Lank v. N.Y. Stock Exch*., 548 F.2d 61, 67 (2d Cir.1977)); *See Jarrett v. Kassel*, 972 F.2d 1415, 1426 (6th Cir. 1992) (holding that a receiver "had authority to sue on behalf of the receivership itself but had no authority to bring a cause of action on behalf of the individual customers"). "[l]ike a trustee in bankruptcy or for that matter the plaintiff in a derivative suit, an equity receiver may sue only to redress injuries to the entity in receivership, corresponding to the debtor in bankruptcy and the corporation of which the plaintiffs are shareholders in the derivative suit." *Scholes v. Lehmann*, 56 F.3d 750, 753 (7th Cir. 1995).

A Petition for Certioari regarding the circuit split is before the Supreme Court of the United States for review. *See Barry L. Rupert, et al. v. Ralph Janvey, et al., case no.* 19-1411 in the Supreme Court of the United States; *Antonio Jubis Zacarias, et al. v. Ralph S. Janvey, et al*., case no. 19-1402 in the Supreme Court of the United States. Thank you to PIABA Amicus Committee, Royal B. Lea, in particular, for drafting and filing an amicus brief on the issue.

Outcome: PIABA Pete spends eleven long years litigating with the Receiver over who owns the securities fraud claims against Burt, the partnerships, and the offshore banks. This litigation prompts Burt to relocate to Florida. PIABA Pete is questioning his judgment to proceed with an SEC receiver as opposed to proceeding with a bankruptcy plan.

2) DON'T VOTE FOR THAT CHAPTER 11 PLAN-YOU MAY BE RELEASING CLAIMS AGAINST THIRD-PARTIES.

Change in facts: PIABA Pete files an involuntary bankruptcy petition against Super-Mega and a chapter 11 trustee is appointed. The trustee files a plan of reorganization and tries to recover the limits of the Oakmont Financial Planners' E&O policy on behalf of the bankruptcy estate. Within the trustee's plan of reorganization, all creditors voluntarily (but likely unknowingly) give up claims against third parties. The Devil is always in the details. The following provisions are buried within the fifty-page plan:[1]

- Defined Terms
  - Contributed Claims
    - All Causes of Action . . . against any Person that is not a Released Party and that are related in any way to the Debtors . . . including . . . (b) all Cause of Action for unlawful dividend, fraudulent conveyance, fraudulent transfer, voidable transaction, or other avoidance claims under state or federal law; (c) all Causes of Action based on, arising out of, or related to the misrepresentation of any of the Debtors' financial information, business operation, or related internal controls . . . .

- Liquidating Trust
  - Contribution of Contributed Claims
    - [A]ll Contributed Claims will be irrevocably contributed to the Liquidation Trust and shall thereafter be Liquidation Trust Actions for all purposes.
  - Pursuit and Resolution of Liquidation Trust Actions

    The Liquidating Trust . . . will have the exclusive right, power, and interest on behalf of itself, the Debtors, the Estates, and the Contributing Claimants to institute, commence, file, pursue, prosecute, enforce, abandon, settle, compromise, release, waive, dismiss or withdraw any and all Liquidation Trust Actions or Assets[.]

Applicable statutory provision – 11 U.S.C. § 1126(c):

> (c) A class of claims has accepted a plan if such plan has been accepted by creditors, other than any entity designated under subsection € of this section, that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors, other than any entity designated under subsection € of this section, that have accepted or rejected such plan.

Applicable statutory provision – 11 U.S.C. § § 1129(a)(8); (b):

> (a) The court shall confirm a plan only if all of the following requirements are met:

[1] Provisions from the *Joint Chapter 11 Plan of Liquidation of Woodbridge Group of Companies, LLC and its affiliated Debtors*, Case No. 17-12560, filed in the United States Bankruptcy Court District of Delaware [ECF No. 2138].

(7) With respect to each impaired class of claims or interests—
(A) Such class has accepted the plan; or
(B) Such class is not impaired under the plan.

(b)[I]f all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair in equitable, with respect to each class or claims of interests that is impaired under, and has not accepted the plan.

Analysis:

For a plan to be confirmed one of the following must occur: 1) each class must be non- impaired; 2) each impaired class must vote to approve the plan; or 3) the requirements of "cramdown" contained in 11 U.S.C. § 1129(b) must be met. An impaired class accepts a plan if at least one-half of the class' claimants containing two-thirds of the aggregate dollar amount for the class' claims vote to approve the plan. 11 U.S.C. § 1126(c).

Although courts are divided, the majority of courts hold that a non-voting class is not deemed to have accepted the plan. *In re Vita Corp.*, 380 B.R. 525, 527 (C.D. Ill. 20008) (*citing In re Eagle-Picher Indus*., 203 B.R. 256 (S.D. Ohio 1996); *In re Westwood Plaza Apartments, Ltd.*, 192 B.R. 693 (E.D. Tex. 1996); *In re M. Long Arabians*, 103 B.R. 211 (9th Cir. 1989); *In re Smith*, 2006 Bankr. LEXIS 3196, 2006 WL 3627298 (Bankr. M.D. N.C. 2006); *In re Jim Beck, Inc.,* 207 B.R. 2010 (Bankr. W.D. Va. 1997); *In re Higgins Slacks Co.,* 178 B.R. 853 (Bankr. N.D. Ala. 1995); *In re 7th Street & Beardsley P'ship*, 181 B.R. 426 (Bankr. D.Ariz. 1994); *In re Adkisson Vill. Apts. of Bradley County, Ltd*., 133 B.R. 923 (Bankr. S.D. Ohio 1991); *In re Friese*, 103 B.R. 90 (Bankr. S.D. N.Y. 1989); *In re Townco Realty, Inc*., 81 B.R. 707 (Bankr. S.D. Fla. 1987)). Within the Southern District of Texas, a bankruptcy court ruled that a plan is not confirmable where no creditors vote on a plan, holding that each impaired class must affirmatively accept the plan. *In re Castaneda*, 09-50101, 2009 WL 3756569, at *1 (Bankr. S.D. Tex. Nov. 2, 2009). On the other hand, the Tenth Circuit Court of Appeals held that a creditor who is the sole member of a class is deemed to have accepted a plan of reorganization if it does not vote or object to the plan. *Heins v. Ruti—Sweetwater, Inc., (In re Ruti-Sweetwater, Inc.*), 836 F.2d 1263, 1267-68 (10th Cir. 1988).

Once a plan with a litigation trust is confirmed, a trustee will proceed in pursuing the claims in order to provide payout to the class. It is important to note that a litigation trust's standing to pursue a claim post-confirmation must be expressly provided for in the debtor's plan. *See Dynasty Oil & Gas, LLC v. Citizens Bank et al. (in re United Operating, LLC)*, 540 F.3d. 351, 355 (5th Cir. 2009). While some D&O carriers may have several exclusions in a policy, it is important to evaluate the exceptions to the exclusion. Several courts have concluded that the insured vs. insured exclusion is not trigged by a lawsuit brought by a successor-in-interest against former directors for breach of fiduciary duty. *In re Palmaz Scientific, Inc.*, 2018 WL 3343597, *13 (Bankr.W.D. Tex. 2018).

Outcome: Lily votes for the plan so that she can at least receive the 10% distribution proposed. PIABA Pete continues with the FINRA arbitration against Burt Blackheart, but failed to get the automatic stay lifted. Although PIABA Pete was happy to hear the plan was confirmed, Judge King holds PIABA Pete in contempt for violating the discharge injunction in the plan. PIABA Pete has a BAD day.

3) WE DON'T NEED TO FIGHT ANY MORE AFTER THE FINRA PANEL HAS RULED. DEBTS ARISING FROM SECURITIES VIOLATIONS (EVEN THE UNSUITABLE ONES) ARE NOT DISCHARGEABLE.

Change in facts: Burt is sued by several clients for the same investments, and the wasting E&O Policy is now exhausted or frozen by the courts. Burt receives poor legal advice and files for bankruptcy to stop Lily's FINRA Arbitration. Burt Blackheart's bankruptcy case gets assigned to Judge Gargotta. PIABA Pete proceeds to lift the automatic stay and receives a FINRA Arbitration Award. The award comes down for $10,000.00 for unsuitable investment advice. There is no specific award for Blue Sky, '33 Act or '34 Act claims. Burt is not concerned because he thinks the Arbitration Award will be discharged by the bankruptcy court. Maybe not so fast.

Applicable statutory provision – 11 U.S.C. § 523(a)(19)

(a) A discharge under section 717, 1141, 1192,[2] 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

…

(19) that—

(A) is for—

(i) the violation of any of the Federal securities laws, … any of the State securities laws or any regulation or order issued under such Federal or State securities laws; or

(ii) common law fraud, deceit, or manipulation in connection with the sale of any security; and

(B) results, before, on or after the date on which the petition was filed, from—

(i) any judgment, order, consent order, or decree entered in by any Federal or State judicial or administrative proceeding;

[2] Small Business Reorganization Act, Pub. L. 116-54 effective February 19, 2020.

(ii) any settlement agreement entered into by the debtor; or

(iii) any court or administrative order for any damages, fine penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.

Analysis:

The creditor carries the burden to show a debt is nondischargeable under any discharge exception within 11 U.S.C. § 523. *Grogan v. Garner,* 498 U.S. 279, 283 (1991). It is in the bankruptcy court's authority to determine if a debt is nondischargeable. *Dennis v. Dennis (In re Dennis)*, 25 F.3d 274, 277 (5th Cir. 1994) (citing *In re Shuler*, 722 F.2d 1253, 1265 (5th Cir. 1984), *cert. denied*, 469 U.S. 817 (1984). If a "'tribunal other than the bankruptcy court [determines]. . . whether a federal or state securities violation or some type of related fraud has occurred,' the [bankruptcy c]ourt should not disturb or attempt to relitigate those findings." *See Jenkins v. Jones (In re Jones)*, 600 B.R. 561, 569 (Bankr. W.D. Tex. 2019) (quoting *Wright v. Minardi (In re Minardi)*, 536 B.R. 171, 192 (Bankr. E.D. Tex. 2015). However, the bankruptcy court may inquire into the true nature of the underlying debt litigated in state court or in arbitration if necessary. *Dennis*, 25 F.3d at 277 (citing *Brown v. Felsen*, 442 U.S. 127, 138 (1979).

For a debt to be excepted from discharge due to a violation of securities law under § 523(a)(19), a creditor must prove that "(1) the debt is for violation of securities law or for common law fraud in connection with the sale of a security; and (2) the debt must be memorialized in a judicial or administrative order, or in a settlement agreement." *Wright v. Minardi (In re Minardi)*, 536 B.R. 171, 191 (Bankr. E.D. Tex. 2015) (citing *McGraw &Pfeifer Sutter Fam. LLC v. Collier (In re Collier)*, 497 B.R. 877, 903 (Bankr. E.D. Ark. 2013).

A FINRA award memorialized by a judicial order provides a bankruptcy court sufficient evidence to except a debt from discharge. *Jones*, 600 B.R. at 569. Even if a FINRA award does not specifically issue findings of specific violations of securities laws, fraud, or breach of fiduciary duty, the award may be nondischargeable if "the FINRA [a]ward arose, at least in part, in connection with [debtor's] violation of [state] securities laws." *Id.*

Some courts have addressed nuances in excepting a debt from discharge. For example, the Tenth Circuit Court of Appeals affirmed a ruling discharging judgments for unjust enrichment in connection with a Ponzi scheme. *Oklahoma Dept. of Securities, ex. Rel. Fought v. Wilcox*, 691 F.3d 1171, 1177 (10th Cir. 2012). In *Wilcox,* creditors sued debtors in state court for unjust enrichment but did not pursue any actions for securities law violations. *Id*. at 1176-77. Creditors successfully obtained judgments, and the bankruptcy court excepted the judgments from discharge.

Id. at 1174. The Tenth Circuit reversed the bankruptcy court based on a strict interpretation of § 523(a)(19), stating that a judgment only for unjust enrichment was not a judgment "for a violation" of securities law. *Id.* at 1174-75. The appellate court clarified that the ruling may have been different if the creditor prosecuted debtors for securities law violations in state court. *Id.* at 1176-77.

The Eleventh Circuit Court of Appeals determined that liability arising from a third party's violation of securities laws may be excepted from discharge. *Lunsford v. Process Techs. Servs. (In re Lunsford)*, 848 F.3d 963 (11th Cir. 2017). Within *Lunsford*, a creditor sued the debtor and the company in which the debtor served as president and obtained an arbitration award. *Id.* at 965. The award detailed the securities law violations and stated explicitly that the award's findings would include the debtor unless only the company was referenced. *Id.* at 967. The state court confirmed the award and entered a joint and several judgment against the company and debtor. *Id.* at 965. The debtor asserted that the debt was dischargeable because he was merely a third party to the violations of securities laws. *Id*. at 969. The bankruptcy court determined the debt was excepted from discharge because the debtor was a party to the legal action in which a judgment was entered for securities laws violations against the company. *Id.* The appellate court affirmed the bankruptcy court and acknowledged that the ruling may be inconsistent with *Wilcox*, and nevertheless stated "[t]he whole text establishes section 523(a)(19) precludes discharge regardless of whether the debtor violated securities laws as long as the securities violation caused the debt." *Id.* at 968. A critical difference between *Lunsford* and *Wilcox* is that in *Lunsford*, the debtor was jointly and severally liable for the securities laws violations, whereas in *Wilcox*, the debtor was not charged with any securities law violations.

Outcome: The debt owed to Lily is excepted from discharge. PIABA Pete now moves forward in attempting to collect the debt. Burt's entire net worth is tied up in his newly remodeled home and yacht, both of which he has claimed as exempt under the Texas Property Code.

4) HAND OVER YOUR HOMESTEAD, OR AT LEAST ALL VALUE ABOVE $170,350.00, A LA CLYDE JONES

Change in facts: Burt claimed the full value of $5,000,000.00 as exempt as a homestead under Texas law. Burt also attempted to claim the yacht as exempt, but subsequently amended his schedules without requiring PIABA Pete or the trustee to file an objection. Trustee and PIABA Pete proceed to file an objection to Burt's claimed homestead exemption. Burt filed a reply, asserting that the Texas homestead protects his residence's full value, or in the alternative, the newly remodeled home is necessary to support him and his spouse. As an exhibit in support of the reply, Burt attaches a doctor's note saying it is necessary for Burt's health to swim in his resort-styled pool and play tennis at his private tennis court three times a week.

Applicable statutory provision - 11 U.S.C. § 522(q)(1)(B):

(q)(1) As a result of electing under subsection (b)(3)(A) to exempt property under State or local law, a debtor may not exempt any amount of an interest in property described in subparagraphs (A), (B), (C), and (D) of subsection (p)(1) which exceeds in the aggregate $170,350[3] if--

(A) the court determines, after notice and a hearing, that the debtor has been convicted of a felony (as defined in section 3156 of title 18), which under the circumstances, demonstrates that the filing of the case was an abuse of the provisions of this title; or

(B) the debtor owes a debt arising from--

(i) any violation of the Federal securities laws (as defined in section 3(a)(47) of the Securities Exchange Act of 1934), any State securities laws, or any regulation or order issued under Federal securities laws or State securities laws;

(ii) fraud, deceit, or manipulation in a fiduciary capacity or in connection with the purchase or sale of any security registered under section 12 or 15(d) of the Securities Exchange Act of 1934 or under section 6 of the Securities Act of 1933;

(iii) any civil remedy under section 1964 of title 18; or

(iv) any criminal act, intentional tort, or willful or reckless misconduct that caused serious physical injury or death to another individual in the preceding 5 years.

(2) Paragraph (1) shall not apply to the extent the amount of an interest in property described in subparagraphs (A), (B), (C), and (D) of subsection (p)(1) is reasonably necessary for the support of the debtor and any dependent of the debtor.

[3] As adjusted under section 104, effective April 1, 2019. To be readjusted effective April 1, 2022.

Analysis:

The objecting party carries the burden in establishing a debtor's claimed exemption is improper. *In re Presto*, 376 B.R. 554, 563 (Bankr. S.D. Tex. 2007). The burden of proof is by a preponderance of the evidence. *Id.;* Fed. R. Bankr. P. 4003(c).

Bankruptcy courts can make findings or adopt rulings from other courts or arbitration panels to limit a debtor's homestead under § 522. To satisfy the requirements under § 522(q)(1)(B)(ii), a debtor must owe a debt arising from the act of fraud, deceit, or manipulation while acting in a fiduciary capacity or in connection with the purchase or sale of a registered security. *Presto*, 376 B.R. at 592. The Bankruptcy Code defines "debt" as "liability on a claim[.]" 11 U.S.C. § 101(12). Congress intended to adopt the broadest definition of the term "claim." *Johnson v. Home State Bank*, 501 U.S. 78, 83 (1991). Within the Bankruptcy Code, "claim" is defined as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured." 11 U.S.C. § 101(5).

If a party requests a debtor's homestead exemption to be capped under 11 U.S.C. § 522(q), a bankruptcy court may permit a debtor to retain the full value of a claimed homestead exemption if the homestead is reasonably necessary for the support of the debtor and debtor's dependents. *See In re Bounds*, 491 B.R. 440, 452-53 (W.D. Tex. 2013). The following factors are considered under the reasonably necessary standard: " (1) the debtor's present and anticipated living expenses, (2) the health of the debtor and his/her dependents, (3) debtor's job skills and education, (4) debtor's other assets, (5) debtor's ability to save for retirement, (6) the special needs of the debtor and his or her dependents, and (7) debtor's continuing financial obligations such as alimony or child support." *Id*. (citing *In re Jackson*, 376 B.R. 75, 80 (Bankr. D. Conn. 2007) ***aff'd,*** *Jackson v. Novak*, 593 F.3d 171 (2nd Cir.2010)).

Bankruptcy courts look at these factors strictly and tend to favor restricting the homestead. Within *Bounds*, the bankruptcy court granted an objection to a debtors' claimed homestead under § 522(q) because the home was more than reasonably necessary for the debtors' needs. *Id*. at 553. Specifically, the home consisted of 4,200 square feet of living space and had a tennis court, barn, a gated driveway, and a private pond. Since the debtors were soon to have no children living at home, had the ability to secure employment, and the capability to downsize to a smaller home, the court determined the homestead exemption should be limited. *Id.* at 453. The court further addressed how one debtor was convicted of fraud and theft in the amount of $500,000.00 against the objecting party, and that the objecting party would not obtain payment from the bankruptcy case if the debtors were entitled to keep the claimed homestead. *Id.* at 454.

Additionally, within *Presto,* the bankruptcy court determined that it was not reasonably necessary for a debtor with substantial income and future earning capacity to live in a two-story 3,400 square foot home with a custom pool in a gated community with a country club, especially when his children only stay during the summer. *Presto*, 376 B.R. at 599. The debtor argued that his pool, which also included a slide and a hot tub, was medically necessary. *Id.* The court clarified the analysis for a medically necessary pool: "The only question this condition would raise is whether the Debtor had sufficient income and other assets to afford *any* house, not this specific house, that can provide a pool." *Id.* The court also included a footnote expressing doubt about the accuracy of the debtor's medical need for a pool, as debtor's application to build the pool simply requested expedited approval for his children and did not mention the medical necessity. ("If I didn't have my

beautiful children to please, I would not be asking for accelerated approval, but please understand (like all good Daddy's [sic]), I want to put a big smile on my children all summer.") *Id.* at FN 51.

Outcome: The Homestead is sold for $2,000,000 because oil prices collapsed, and no one is buying these kinds of homes during a pandemic. After all of the closing costs and expenses are paid, Mr. Blackheart receives $170,350 and Lily and PIABA Pete receive a check for $1.5 million. Lily is paid her $1,000,000. PIABA Pete makes a nice fee that just covers the actual time his has put in the case over the last five years. PIABA Pete goes back to work the next day.

PERSUASION TECHNIQUES FOR TRIALS & HEARINGS

Celiza (Lisa) Bragança[1]

Sometimes the mechanics of filing a statement of claim, selecting arbitrators, conducting discovery, motion practice, and preparing for mediation or hearings can eclipse the importance of developing and sticking with a persuasive trial strategy. In large part trying a case in FINRA arbitration is the same as trying a case before a federal court jury.

The best trial attorneys are continually trying to be better. That often means returning to the fundamentals. This is a brief discussion of a few fundamental principles of trial practice that are worth revisiting from time to time.

Humanize your client

In customer arbitrations, we want arbitrators to see our clients as human beings who were wronged. Even when our client is a business, that business is made up and operated by human beings who have been injured.

Humanizing the client is such an important consideration that trial practice guru James W. McElhaney devoted an entire chapter of his book to it. *See* ***McElhaney's Trial Notebook***, ch. 12, 3d ed. (ABA 1994). Everything we and our clients do in front of arbitrators should reinforce the humanity of our clients. There are many ways to do this.



Use your client's name

One important way to humanize a client is to call them by their name, rather than refer to them as "claimant." As McElhaney puts it, if you want a decisionmaker to understand your client as an actual human being, "with senses and emotions, memories and anticipations, duties and

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obligations, who is entitled to fundamental dignity and a rightful place in the world," you should use your client's name. McElhaney's Trial Notebook, at 98.



McElhaney further encourages lawyers to, whenever possible, refer to a client by their ***first*** name. *Id.* This is dependent, of course, on the client's age, sex, and other characteristics. Whatever you do should feel comfortable and respectful. This should start with the Statement of Claim and continue in discovery requests, motions, oral argument, and ultimately through the final hearings and post-hearing briefs. You reinforce at every opportunity that your client is not a Fortune 500 corporation, but a living breathing human being.

Your client's appearance matters

Before you have your client appear in person, you should make sure the way your client looks and acts supports your theory of the case. Arbitrators and mediators will make conscious and unconscious decisions about your client based upon their appearance and behavior. They will also make decisions based upon how you introduce your client and how you interact with your client.

Here is one example. In one federal court trial, a client of mine was an almost defunct foreign corporation, whose regular lawyer flew in to serve as corporate representative. The lawyer's wife, also a lawyer, accompanied him to court each day. On the first day of trial – in the dead of winter – we were startled to see the lawyer's wife come to our offices wearing a mink coat. We asked her to wear a different coat to court to avoid giving off the impression of great wealth or otherwise offending jurors.

An issue that often comes up with indigent clients seeking fee waivers is they may overdress for court hearings, leading judges to believe they are not really indigent. An indigent client might borrow an expensive suit and be wearing a knock-off of an expensive watch. Talk to clients about not giving an impression that undercuts your case.

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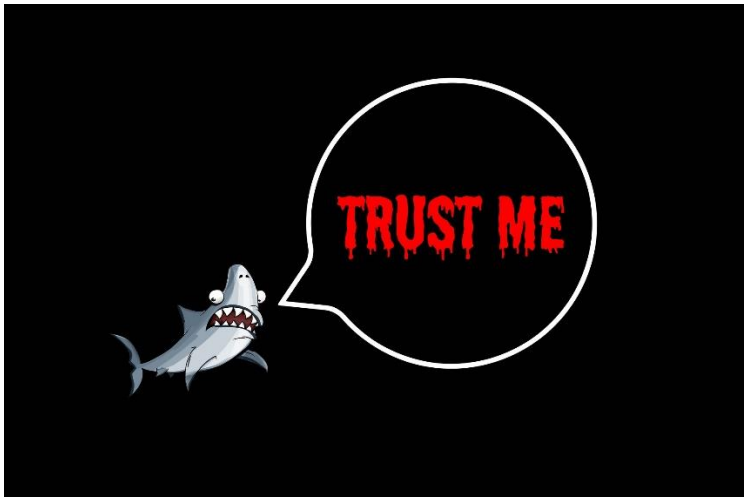


Your credibility matters

Our success at trial depends in large part on our credibility as lawyers. As McElhaney puts it, underlying every trial is the following progression:

> I am honest.
> You should believe me.
> I believe in the justice of my client's cause.
> Therefore, you should decide for my client.

McElhaney's Trial Notebook, at 108. We all think we satisfy these statements but we should critically assess whether we are clearly and consistently conveying that impression to arbitrators or mediators.



There are many ways that we can convey honesty and credibility. Having a theory of the case that you really believe is a significant factor. Being respectful of arbitrators and opposing counsel, listening attentively and respectfully to testimony of your client and other witnesses is important. And, showing respect and compassion to your client – even when out of the hearing room – can support your credibility and your case. There is nothing that can replace having a reputation with arbitrators and other lawyers of being scrupulously fair and honest.

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You want the arbitrators to like you because that makes it easier for them to trust you. As one litigator noted, credibility as a lawyer is based on the same factors as credibility in marketing: know, like, trust, believe. Kenneth Berman, "Rethinking Credibility and the Burden of Proof" (GPSolo Magazine May/June 2020), available at https://www.americanbar.org/groups/gpsolo/publications/gp_solo/2020/may-june/rethinking-credibility-burden-proof/.

It is important to avoid doing something that offends the arbitrators. I was once one of two lawyers from big firms serving on a jury in a medical malpractice case. (It still mystifies me how we both were chosen.) It was striking how much the nonlawyer jurors talked about the lawyers. Jurors are instructed not to discuss the case, but I understand they often discuss the lawyers. At one point, several jurors expressed their fury about how disrespectful defense counsel's cross examination of the plaintiff was. This was a very experienced medical malpractice defense lawyer from a big firm obviously hired by the malpractice insurer. It was impossible for the jury to avoid imputing the bad conduct of the doctor's lawyer to the doctor.

Create a winning theme

It is important to create a winning theme that is not just factually just, but emotionally just. As Louis Nizer said,

"We believe with heart and soul what we want to believe. Fundamentally, this is the essence of persuasion. If one can be made to wish emotionally that a certain result should obtain, he will find any argument appealing which achieves that goal."

Ralph Adam Fine, ***The How-To-Win Trial Manual***, at 14 (3d ed. 2005) (quoting Nizer's book ***My Life in Court***). Our job in customer arbitrations is to make the arbitrators *want* to make an award to the customer. The theme must be consistent with what arbitrators know from their own lives and consistent with all the facts. In addition, a winning theme should be the simplest explanation that makes sense. A winning theme should account for the facts that you know and that could arise, expected defenses, and preexisting biases of the decisionmakers.

In a world of social media, your theme should be concise and compelling. I have seen great trial lawyers test out alternative versions of a trial theme on colleagues over many months.

Get and keep the panel's attention

Whether we are presenting in person or remotely, it is important to get the attention of arbitrators and keep their attention. This requires a great deal of planning. It also means we should have a compelling story that we deliver in an engaging way that is supported by compelling visuals.

Tell a compelling story

Creating a compelling story is sometimes the hardest work in a case. How do we make this particular customer dispute compelling even though it may be just like many others the panel has seen. While this is something our members do all the time, I offer a few ideas that might help you develop different stories.

It is always helpful to see how great lawyers have told stories. On YouTube you can watch the opening statements and closing arguments given in the People v. O.J. Simpson and other trials.

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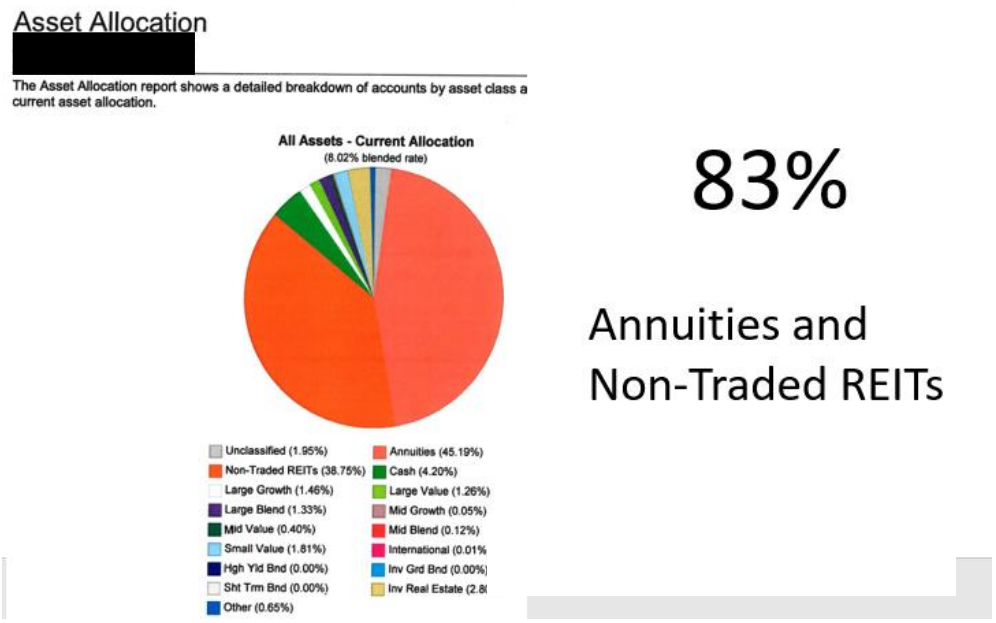
O.J. Simpson trial , available at https://www.youtube.com/watch?v=bkrxarLhX7A&list=PL6Oa8D6FJiFKN-snSqRGYZUsFTspwk4ze. You can also read some of the great opening statements and closing arguments given by trial lawyers like those in **In the Interest of Justice – Great Opening and Closing Arguments of the Last 100 years** (2005), available at https://www.amazon.com/Interest-Justice-Opening-Closing-Arguments/dp/0060509678/ref=tmm_pap_swatch_0?_encoding=UTF8&qid=&sr=.

When you read or hear something that strikes you as great, make a note of it. Those notes can help you come up with different ways to tell a customer's story at hearing. Reviewing great writing about complicated esoteric topics can give you ideas about how to talk about the complex products and interactions that come up in our cases.

One example of an incredibly complex story that was told in a compelling way is a This American Life story called The Giant Pool of Money, available at https://www.thisamericanlife.org/355/the-giant-pool-of-money. Ordinarily you would not expect a story of the epically complicated process of packaging mortgages into Collateralized Debt Obligations to be a hit, but it was. Ira Glass and his collaborators figured out how to make this complicated story so interesting that they produced a follow-up story, Return to the Giant Pool of Money, available at https://www.thisamericanlife.org/390/return-to-the-giant-pool-of-money. The same can be said of **The Big Short** by Michael Lewis and many other financial reporters and authors.

Use compelling visuals

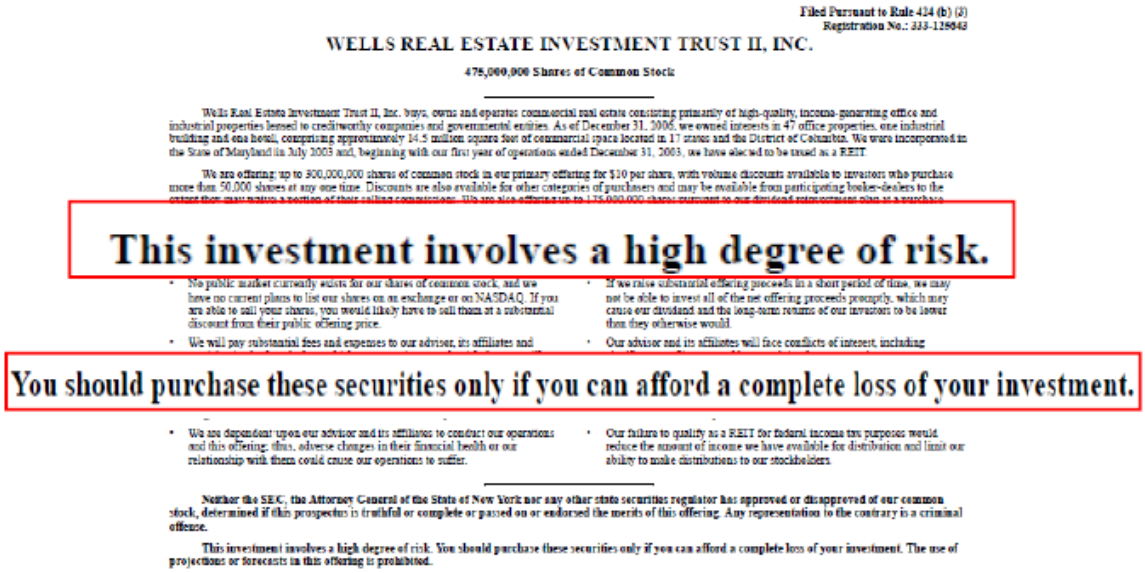
Creating persuasive visuals takes time and energy but the right visuals can make all the difference. The point is to create "visual memories" that stay with the decisionmaker. *See* Kerri L. Ruttenberg, ***Images with Impact – Design and Use of Winning Trial Visuals***, at 23 (ABA 2017). Visual images can be documents from the case, charts, graphs, pictures, timelines, or graphics. The pie chart below was used by a financial advisor repeatedly to show a customer all investments.



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I frequently pointed out how respondent's agent used very similar shades of orange for the annuity wedge and the non-traded REIT wedge. This visual was a constant reminder that the agent himself considered the equity indexed annuities to be securities and to be similar to the non-traded REITs. I used a form of this visual in every document I submitted to the panel – statement of claim, discovery motions, responses to discovery motions, final prehearing briefs – and was planning to have a nice big blow-up of this in the hearing room.

It is important to minimize the number of words appearing on a visual. The slide/visual should only contain information that is relevant and should present it in a compelling way. If you want to put a document with lots of verbiage on it before the panel, use pullouts to direct the panel's attention to the specific part or language you want them to focus on. Here is one example:



Filed Pursuant to Rule 424 (b) (3)
Registration No.: 333-125043

WELLS REAL ESTATE INVESTMENT TRUST II, INC.

475,000,000 Shares of Common Stock

Wells Real Estate Investment Trust II, Inc. buys, owns and operates commercial real estate consisting primarily of high-quality, income-generating office and industrial properties leased to creditworthy companies and governmental entities. As of December 31, 2005, we owned interests in 47 office properties, one industrial building and one hotel, comprising approximately 14.5 million square feet of commercial space located in 17 states and the District of Columbia. We were incorporated in the State of Maryland in July 2003 and, beginning with our first year of operations ended December 31, 2003, we have elected to be taxed as a REIT.

We are offering up to 300,000,000 shares of common stock in our primary offering for $10 per share, with volume discounts available to investors who purchase more than 50,000 shares at any one time. Discounts are also available for other categories of purchasers and may be available from participating broker-dealers to the extent they may receive a portion of their selling commissions. We are also offering up to 175,000,000 shares pursuant to our dividend reinvestment plan at a purchase

This investment involves a high degree of risk.

- No public market currently exists for our shares of common stock, and we have no current plans to list our shares on an exchange or on NASDAQ. If you are able to sell your shares, you would likely have to sell them at a substantial discount from their public offering price.
- We will pay substantial fees and expenses to our adviser, its affiliates and
- If we raise substantial offering proceeds in a short period of time, we may not be able to invest all of the net offering proceeds promptly, which may cause our dividend and the long-term returns of our investors to be lower than they otherwise would.
- Our advisor and its affiliates will face conflicts of interest, including

You should purchase these securities only if you can afford a complete loss of your investment.

- We are dependent upon our advisor and its affiliates to conduct our operations and this offering; thus, adverse changes in their financial health or our relationship with them could cause our operations to suffer.
- Our failure to qualify as a REIT for federal income tax purposes would reduce the amount of income we have available for distribution and limit our ability to make distributions to our stockholders.

Neither the SEC, the Attorney General of the State of New York nor any other state securities regulator has approved or disapproved of our common stock, determined if this prospectus is truthful or complete or passed on or endorsed the merits of this offering. Any representation to the contrary is a criminal offense.

This investment involves a high degree of risk. You should purchase these securities only if you can afford a complete loss of your investment. The use of projections or forecasts in this offering is prohibited.

Here I copied the language from the document for the pullouts, but I could have made the language easier to read by typing the quoted language into a text box. In this case, I was trying to emphasize that these words came directly from the document.

When using tools like PowerPoint it is important to avoid the pitfall of putting too much text on slides. The slides should be compelling visuals, not a summary of what you are saying to the panel. Even very simple text slides can be compelling when you use techniques like text builds and pullouts of key language from documents. The key is to eliminate the extraneous. You do not want to fill all the empty space on the slide.

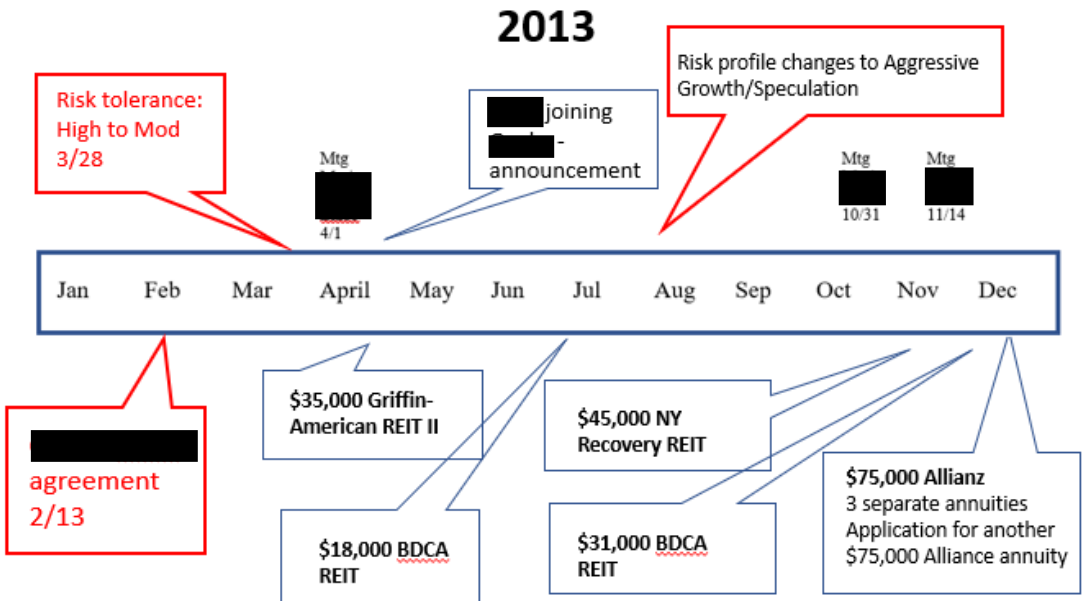
An effective visual can also help you consolidate a huge amount of information to make your point. In this case, respondent argued that the client was sophisticated and had an aggressive growth/speculation investment objective. I prepared the chart below to show that the customer had inconsistent risk tolerances – something that should have been addressed – and to show when her risk tolerance changed.

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Account	2010	2011	2012	2013	2014	2015	2016	2017
[redacted] Trust	Growth & Moderate	Growth & Moderate	Growth & Moderate	Aggressive Growth & Speculation*	Aggressive Growth & Speculation	Aggressive Growth & Speculation	Aggressive Growth & Speculation	
[redacted] IRA	Growth & Moderate	Growth & Moderate	Growth & Moderate	Aggressive Growth & Speculation #	Aggressive Growth & Speculation	Aggressive Growth & Speculation	Aggressive Growth & Speculation	
[redacted] SEP IRA	Growth & Moderate	Growth & Moderate	Growth & Moderate	Growth & Moderate	Growth & Moderate	Growth & Moderate	Growth & Moderate	
[redacted] Roth IRA				Aggressive Growth & Speculation ^	Aggressive Growth & Speculation	Aggressive Growth & Speculation	Aggressive Growth & Speculation	Aggressive Growth & Speculation
[redacted] IRA Advisory						Aggressive Growth & Speculation	Aggressive Growth & Speculation	Aggressive Growth & Speculation
[redacted] Trust Advisory							Aggressive Growth & Speculation	Aggressive Growth & Speculation
[redacted] Roth IRA Advisory								Growth & High Risk

One defense exhibit was used effectively by the defense in a seven month long prosecution of John Gotti. *See* Edward Tufte, Envisioning Information, at 31 (1990). It was a simple chart that could be generated using Excel or Word. It was titled, Criminal Activity of Government Informants. At the top of each column was the name of each witness testifying against Gotti. On the left, was a list of about 20 criminal activities ranging from murder, attempted murder, all the way to reckless endangerment. There are big black X's in many boxes indicating that the witnesses against Gotti had engaged in that particular crime. During deliberations the jury asked to review the chart of witness criminal activities. Gotti was acquitted.

Timelines are particularly important and can be time consuming to create. In one case, I used PowerPoint to create a timeline by having a separate slide for each year. This is one year out of a multi-year timeline I prepared for use at hearing:



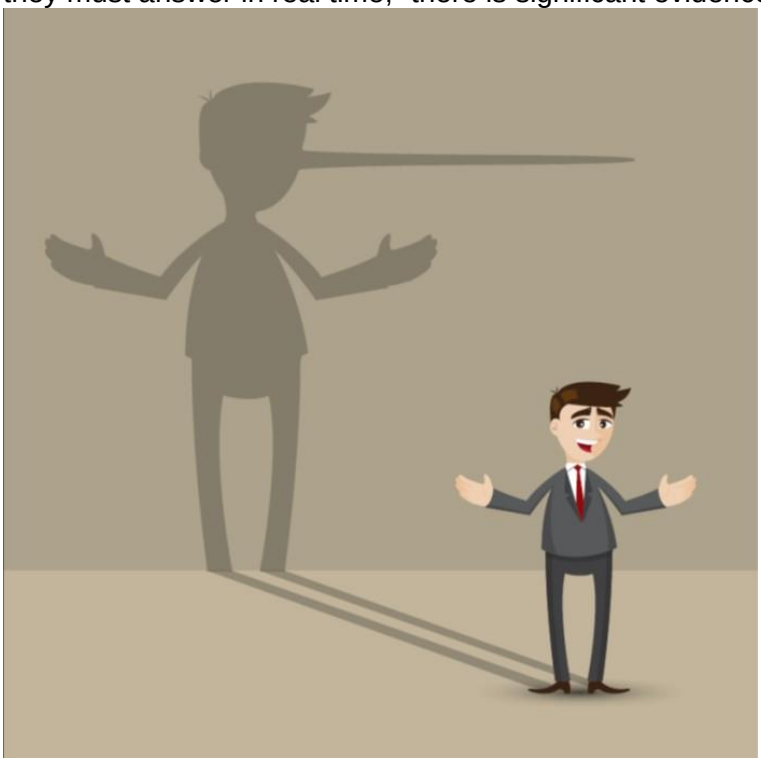
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This barebones timeline allowed me to show that the change in the customer's investment objective to aggressive coincided with a flurry of recommendations and sales to her of annuities and REITs.

Online Arbitration Hearings

As of early August 2020, when these materials were written, there have been a few FINRA customer arbitration final hearings conducted via Zoom as well as some trials in federal and state courts. One resource of note is the Online Courtroom Demonstration Project. https://www.onlinecourtroom.org/demonstration-report. The Online Courtroom Demonstration Project is an advisory task force of judges, lawyers, consultants, and researchers who conducted a two-day demonstration jury trial using Zoom. You can watch the trial in its entirety on YouTube.

There are many who believe in-person trial testimony is essential to due process. For example, the National Institute for Trial Advocacy (NITA) issued a statement expressing concerns about conducting trial online, rather than in person. See NITA's Statement on the Importance of In-Person Advocacy in Courts, available at https://6a1ab614-8a16-459a-b02b-6cb58b4e4148.filesusr.com/ugd/850355_1b41af33eb6d40b69c95e2cd3bc8d650.pdf. While NITA argues that in-person testimony is essential for determining the credibility of witnesses by observing their "responsiveness, demeanor, and how they react to unscripted questions to which they must answer in real time," there is significant evidence to the contrary.



Some studies have shown that juries and other decisionmakers are not very good at determining credibility of witnesses. *See* Maggie Koerth, Why Humans Are Bad at Spotting Lies (FiveThirtyEight.com 9/28/2018) available at https://fivethirtyeight.com/features/why-humans-are-bad-at-spotting-lies/; Laura Zimmerman, Deception detection (APA March 2016) ("Research has consistently shown that people's ability to detect lies is no more accurate than chance, or flipping a coin."). Some research shows that even professionals whose job it is to determine credibility – like those in law enforcement – are not very good at it. *See* Rachel Edelson, Detecting

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deception (APA July/Aug 2004), available at https://www.apa.org/monitor/julaug04/detecting; Julie Beck, Groups are Better than Individuals at Sniffing Out Lies, (The Atlantic Sept. 14, 2015), available at https://www.theatlantic.com/health/archive/2015/09/groups-are-better-than-individuals-at-sniffing-out-lies/405244/. As a result, it remains to be seen whether losing the ability to see a witness testify in person at a hearing is a significant factor in conducting FINRA hearings or jury trials.

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TRIAL TACTICS

Kirk Smith

I. Before

This portion of the session will delve into pre-trial tactics. Obviously, there is a myriad of tasks to be completed during the life of the case. The discussion will be focused on the topics of subpoenas, Florida CRDs, and pre-hearing briefs.

a) Subpoenas

Issuance of subpoenas to third parties is generally warranted in FINRA hearings, though in some instances it may not be necessary. Respondents' counsel will always oppose any subpoena, so it is important to craft a good argument in any motion for issuance of subpoenas. Sometimes it will be necessary to request subpoenas for non-FINRA member third-parties. It may be a good tactic to seek such a subpoena even if it is believed the non-FINRA member will be uncooperative. Filing and arguing the motion may be a good idea just to advance your narrative to the Chairperson. Subpoenas are allowed to be issued by the parties to the Chairperson for approval as provided under FINRA, Rule 12512. According to subsection (a)(2), "unless circumstances dictate the need... arbitrators shall not issue subpoenas to non-party FINRA members." However, the Rule under (a)(2) goes on to state that if circumstances warrant the issuance of non-FINRA member subpoenas, the arbitrators should order such subpoenas. *See generally* FINRA, Rule 12512.

b) Fla. CRDs

FINRA CRDs may contain omissions due to expungements. It’s a good idea to obtain Florida CRDs for all licensed witnesses due to the superior disclosures available on those CRDs. These documents can be obtained via the Florida Office of Financial Regulation. The website is https://www.flofr.com/.

c) Briefs (get evidence in early)

Pre-hearing briefs are of the utmost importance as part of the overall strategy. Besides providing the applicable law, briefs allow the attorney to re-tell the story of the Statement of Claim from the perspective of completed discovery. It is important to attach documents obtained in discovery to the brief or embed sections of documents into the text itself. Obviously, favorable documents should always be included to advance the narrative of the case. The drafter should also consider attaching potentially negative documents so as to put them in the proper context. Respondents' brief may try to spin innocuous documents into something they are not. Whenever applicable the brief should discuss and attach any regulatory documents. These publicly available documents should be explained in detailed yet concise language. The focus should be on why they are important for the Claimants' case specifically. Of course, compromised CRDs should always be included and addressed vigorously. It is also important to address Respondent's defenses, though devoting too much time could backfire. Pre-hearing briefs should not be too lengthy. Try to let the attached or embedded documents speak for themselves. Lastly, don't overdo the legal component of the brief and avoid minutia arguments as the audience is not an appellate court. The primary

focus of the brief should be setting the narrative of the case so the arbitrators view your case favorably prior to the hearings.

II. During

The arbitration hearing itself is the main course to be discussed. It is ultimately what the attorney has prepared for over the past year or more. Key components to be discussed include the all-important opening statement and the use of PowerPoint presentations or other demonstrative aids. It is important to push the envelope on the narrative without straying into a "closing argument". The topic of witness examinations and cross-examinations will be addressed, along with issues such as witness order. Evidentiary issues will be discussed, specifically plus and minuses of agreeing on a set of documents. The use of experts and at what stage they need to be involved or, depending on the case, if one needs to be retained will be commented on. Reading the arbitrators' demeanor and the Chairperson's rulings as a means to audible strategy as the attorney sees fit will be another topic. Lastly for this subsection, the issue of closing arguments and respective styles will be addressed.

a) Opening statements-Push the envelope?

It is of the utmost importance that the opening statement is delivered with zeal, taking every opportunity to address the claimants' plight, the overwhelming evidence, the mendacity of the broker and/or firm, and the revelation of important documents. How far can a claimants' attorney go without straying into an argument? According to FINRA's Initial Pre-Hearing Conference Arbitrator's Script, (July 14, 2020), Section M.," Each party may make an opening statement. It should be limited to what the party intends to prove and should not be a presentation of evidence or of the merits of the case." *See also*, American Bar Association, Rule 3.4(e): Fairness to Opposing Party and Counsel (April 17,2019), a lawyer shall not "allude to any matter that the lawyer does not reasonably believe is relevant or that will not be supported by admissible evidence,...or state a personal opinion as to the justness of a cause, the credibility of a witness..." Balance is important in any presentation to the arbitrators but timidity is no virtue in the prosecution of your clients' case. There are benefits to pushing the envelope, just be sure not to alienate the arbitrators. A common tactic to advance your cause in an opening statement is to utilize phrases, "the evidence will show..." and, "at the hearing, it will be demonstrated..." PowerPoint presentations or other demonstrative aides should always be used. Themes developed in motion to compel discovery, subpoenas, and the brief should be advanced. Important documentation, including regulatory documents, should be on a slide or flip chart. Enlarged or highlighted versions of documents and manufactured slides should be displayed and opined on. Get it out in front of the arbitrators and worry about admissibility later. There pitfalls to saying too much of course. Avoid spending too much of your time attacking respondents' defenses, it could backfire, but do address them. Repetition is important, hammer themes, key concepts, and good evidence, just don't "beat a dead horse."

b) Examinations/Cross-Examinations- Witness Order depends on the case?

There are various strategies involving witness order. Opinions vary and are often dependent on the type of case. Product cases may call for an expert witness being the first to testify, while a standard suitability case may require the broker to be the first on the stand. Sometimes there situations to

put the client on first, though its a risky proposition as the broker will just counter everything your client says. Generally, suitability/supervisory experts go last, but some situations may warrant a different order. Again, the repetition of evidence through various witnesses is important, thus advancing the narrative. For some arbitrators repetition is important so your point is made. Just try not to go too far. According to Rule 611 (a) of the Federal Rules of Evidence, examination procedures should be "effective for determining the truth, avoid wasting time; and protect witnesses from harassment or undue embarrassment." Under subsection (b) "Cross-examination should not go beyond the subject matter of the direct examination and matters affecting the witness's credibility." Subsection (c) states that "leading questions should not be used on direct examination except as necessary to develop the witness's testimony" but that such will be allowed on "(1) on cross-examination; and (2) when a party calls a hostile witness, an adverse party, or a witness identified with an adverse party." Clearly, any of the Respondents' witnesses can and should be asked leading questions. Sometimes it may be necessary to lead your own witness beyond what is normally permissible. Try not to do it sequentially, best practice is to break it up some.

c) Evidence- To Agree or not to Agree that is the question?

According to FINRA Rule 12604 (a), "...the panel is not required to follow state or federal rules of evidence," but (b) "Production of documents in discovery does not create a presumption that the documents are admissible at the hearing..." Arbitrators are generally very liberal in the admission of evidence. A common refrain is "we will admit it and assign what weight, if any, to the evidence." Don't assume something will be inadmissible, go for it. The concept of "everything admissible unless a party objects" is becoming more common as are other tactics to streamline the hearings. The arbitrators appreciate the parties' efforts. There are situations were joint exhibits might make sense. For example, one set of books filled with statements and confirmations.

d) Experts- Can't live with them, can't live without them?

Expert witnesses are invaluable but can be expensive. In some instances, they may not be needed. There are various stages of the case in which to engage an expert. Some attorneys will only retain a suitability/supervisory expert if it seems the case will likely go to hearing. Such a strategy could be a risky proposition. Damages experts may be retained early to get a good handle on the case. Product experts are necessary early on due to the complexities of the situation. Rule 702 of the Federal Rules of Evidence state, that an expert may offer opinion testimony if:

> (a) the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue;
> (b) the testimony is based on sufficient facts or data;
> (c) the testimony is the product of reliable principles and methods; and
> (d) the expert has reliably applied the principles and methods to the facts of the case.

As with evidence, FINRA Panels are fairly lenient with the admission of a witness as an expert. It is important to lay a proper foundation and discuss what documents were reviewed. Sometimes, opposing counsel will just agree to the admission, but not often. Though these witnesses are experts in their field, its important for any attorney to understand that they are in charge of the case and it is their narrative to advance. Sometimes experts will seize on documents or concepts that they will want to focus on. If you feel that such items or ideas are counter-intuitive to your case, or you just

prefer to focus on other aspects of the case, its okay to politely inform the expert. Most understand where you are coming from and will abide. An attorney can shape or hone an expert's testimony, just don't try to put words in their mouth.

e) Reading your Audience- Did they really just ask that question?

Many a seasoned attorney will argue that reading the arbitrators' demeanor, questions and the Chairperson's rulings is one of the most important skillsets for an attorney. It is important to alter strategies, rearrange and/or omit witnesses, and narrow the amount of evidence presented if necessary. Sometimes continued repetition is in order. Almost all experienced FINRA attorneys have experienced a situation where halfway through the case, one of the arbitrators asks a question demonstrating he or she has no clue what the case is about. At the very least the arbitrator has a misunderstanding of one of the key components. If possible, at that juncture return to a document already admitted and try to address the misunderstanding. It may not always be that simple though.

f) Closing- Argue, Argue, Argue: Find your inner Brando/Streep?

FINRA's Initial Pre-Hearing Conference Arbitrator's Script, (July 14, 2020), Section S states that "parties are directed to limit their closing argument to a summation of what he or she believes has been proven." *The Note* to Section S allows "claimants to proceed first in closing argument, with rebuttal argument being permitted. Claimants may reserve their entire closing for rebuttal." The closing argument is usually most attorneys' favorite part of the case. Its common practice for claimants' attorneys to take the opportunity to go last so as to counter respondents' counsel's highlights and generally have the last word. At this juncture, the Panel is tired, they believe they understand the case and remember every bit of evidence/testimony. Removed of the constraints of the opening, its time to put on a show. Be passionate, accusatory, and powerful. If you feel comfortable, stand to deliver the closing. Once again, the use of PowerPoint and/or other demonstratives to highlight evidence or testimony is vital. Do not just repeat the opening. Testimony or other documents may have been revealed. Questions by the Panel may indicate they are interested in a particular angle you gave only minor thought too. Reinforce what aspects of the case appeals to them. Read the Panel, maybe the closing should be toned down, maybe more time should be spent on the law. Sometimes, its clear the Panel is on your side so addressing damages or legal fees may take priority. Always finish with a killer closing comment and always thank the Panel.

III. After

With the hearing concluded, what are the next steps, if any? Two common concepts are post-hearing negotiations and confirmation of the award.

a) Confirmation?

Generally, Confirmation of an award is not necessary and may lead to an inadvertent Motion to Vacate. If there are collection issues with individuals no longer licensed (or likely to leave the business) it may be necessary to seek confirmation so as to pursue collection. A party may seek an order from the court confirming the award. Under the Federal statute "the court must grant such an order unless the award is vacated, modified, or corrected... application may be made to the

United States court in and for the district within which such award was made." 9 U.S. Code § 9. As stated above, the adverse party may seek vacatur or some form of modification.

b) Post-Negotiation?

After all the hard work, should settlement negotiations continue? Some say let the chips fall where they may. However, situations may develop where either side may feel more comfortable finding out where their counterparts are in payment or acceptance. Often a mediator who was involved in earlier failed negotiations may reach out to the parties. That may be a good sign.

USING THE LAW OF AGENCY IN REPRESENTING INVESTORS

Robert S. Banks, Jr.

INTRODUCTION

Agency law can be helpful to establish the liability of a broker-dealers or registered investment advisory firms ("RIAs") that disclaim responsibility for the advisor's wrongful conduct. The issue most commonly arises where the tortious acts were either not approved or were actually expressly prohibited by the firm. Examples include selling away, unauthorized withdrawals from client accounts, use of powers of attorney to convert client funds, and other bad acts committed by unscrupulous advisors. This article reviews general principles of agency law to consider when prosecuting those claims.

Agency law is a matter of state common law, and there are of course variations in the precedents that exist in the various states. It is beyond the scope of this short article to review cases in particular jurisdictions. But the source for most agency law is the American Law Institute's Restatement (Third) of Agency (2006) and Restatement (Second) of Agency (1958), and courts frequently rely on both of them as if they were state statutes. Counsel will need to research the decisions in the state that govern the dispute, and a starting point for that research ought to be the Restatements.

LIABILITY OF PRINCIPAL FOR ACTS OF AGENT WHERE AGENT IS AN EMPLOYEE

Firms routinely argue that there is no agency liability because the representative is not an employee. Regardless of how the firm characterizes the agent for contract, tax, and compensation purposes, however, under *agency* law rules there is sometimes an argument to be made that the individual advisor is an employee.

The familiar *respondeat superior* liability standard is that "*An employer is subject to vicarious liability for a tort committed by its employee acting within the scope of employment."* Restatement (Third) Agency § 7.07(1. For purposes of agency law, the standard for determining employment status is found in Section 7.07(3)(a) of the Restatement (Third): "For purposes of this section, an employee is an agent whose principal controls or has the right to control the manner and means of the agent's performance of work." Comment f to the section identifies the indicia used to determine whether a person is an employee, including whether the agent is engaged in a distinct business, whether the work is customarily subject to a principal's supervision, how the agent is paid (by job or time), and whether the agent's work is a part of the principal's regular business.

In determining whether an act is within the scope of employment, the Restatement (Third) Section 7.07(2) says:

> An employee acts within the scope of employment when performing work assigned by the employer or engaging in a course of conduct subject to the employer's control. An employee's act is not within the scope of employment when it occurs within an independent course of conduct not intended by the employee to serve any purpose of the employer. (Emphasis added).

That section appears to be a bit of a retreat from the Restatement (Second), which said that agency law looks to whether the act is commonly done by servants, the time, place and purpose of the act, whether the act is outside the business of the employer, and whether the act is "seriously criminal." Restatement (Second) of Agency § 229.

Comments b and c to Section 7.07 of the Restatement (Third) shed some light on the present scope of employment standard. Comment b says that even tortious conduct can be within the scope if the employee's conduct was subject to the employer's control unless the course of conduct was "not intended to further any purpose of the employer." Comment c explains that where the employee is acting to further his own purposes, and not the purposes of the employer, he acts outside the scope of employment. Those comments present challenges in cases involving common theft and selling away scenarios where there was no benefit to the firm for the representative's wrongful acts. Some consolation is found in the Restatement (Second) which affirms that "an act, although forbidden, or done in a forbidden manner, may be within the scope of employment" §230. Likewise, "An act may be within the scope of employment although consciously criminal or tortious." Id. § 231.

LIABILITY OF PRINCIPAL WHERE AGENT IS A NONEMPLOYEE

As a general rule, principals are less likely to be liable for the torts of their nonemployee agents than employers are for their employees.[1] The rationale is that principals do not supervise the details of an independent contractor's work to the same extent that an employer supervises an employee. *See, e.g., Anderson v. Marathon Petroleum Co.,* 801 F.2d 936 (7th Cir. 1986)(principal does not monitor independent contractor's performance but is instead concerned with finished product).

There is an argument to be made that the policy behind the rule should not apply to financial advisor cases, where the duty to supervise exists regardless of whether a representative is an employee or independent contractor. Failing that, in a case where the representative is unlikely to be considered an employee under any agency standard, or where the conduct is likely outside the scope of employment, the focus must turn from employment status and scope to those factors discussed below, which impose liability without regard to whether the agent is an employee acting within the scope of employment.

AGENCY LIABILITY OF PRINCIPAL FOR ACTS OF AGENT WHERE PRINCIPAL FAILS TO SUPERVISE OR TRAIN OR SELECTS AN UNQUALIFIED AGENT

Finra Rule 3010 requires broker-dealers to establish and maintain a system to supervise the activities of its associated persons, and many customer complaints include a claim against the broker-dealer for violating the Finra supervision rules. But Rule 3010 need not be the end of the failure to supervise analysis. In addition to tort claims for negligently failing to adhere to Finra requirements, claims may exist for liability based on the agency relationship, especially where the facts present hurdles to a Rule 3010-based claim. And, while Rule 3010 does not directly apply

[1] The Restatement (Third) dispenses of the employee/independent contractor language and refers instead to employees and nonemployees. The change is only intended to modernize the language, as there is no substantive difference between a "nonemployee" and an "independent contractor".

to RIAs and other non-Finra members, the non-members do have hiring and supervision obligations arising under black letter agency law.

The general rule is that a principal is directly liable to a third party harmed by an agent's conduct when *"the principal is negligent in selecting, supervising or otherwise controlling the agent*." Restatement (Third) of Agency § 7.03(1)(b). The rule is amplified by Section 7.05, which provides:(1) A principal who conducts an activity through an agent is subject to liability for harm to a third party caused by the agent's conduct if the harm was caused by the principal's negligence in electing, training, retaining, supervising, or otherwise controlling the agent.

Note that the scope of the Restatement is broader than Finra Rule 3010 because the Restatement specifically imposes liability for negligently hiring an unqualified or unscrupulous representative. Consider Restatement (Third) Section 7.05(2):

> 2) When a principal has a special relationship with another person, the principal owes that person a duty of reasonable care with regard to risks arising out of the relationship, including the risk that agents of the principal will harm the person with whom the principal has such a special relationship.
>
> Comment b. explains the rationale:
>
> In general; relationship to other bases for liability. A foreseeable risk of harm may be created when one person conducts an activity through another person. For example, the actor chosen for a task may lack competence to perform it without endangering others. A task may require using an instrumentality that is dangerous to others unless the user has appropriate skill or supervision. Some tasks require performance in settings that pose a foreseeable risk of criminal or other intentional misconduct against third parties or their property unless the actor is chosen with due care in reference to that risk.

In applying those rules to broker-dealers and RIAs, the requisite "special relationship" with the customer is hard to deny, at least where it is clear from the facts that the investor was a customer of the firm. When a Finra firm or RIA retains the services of a registered principal, representative, or investment advisor representative with a history of associations with boiler rooms, bankruptcies, customer complaints and criminal convictions – which occurs with far more frequency than the public realizes – the firms should not be surprised when their agent cheats a customer. The firms should be held accountable for their choice of agent. The law of agency lends authority to bring such claims.

> Restatement (Third) § 706 is also worthy of consideration. It provides:
>
> **Failure in Performance of Principal's Duty of Protection**
> A principal required by contract or otherwise by law to protect another cannot avoid liability by delegating performance of the duty, whether or not the delegate is an agent.

How often is that rule relied upon in investor cases? Probably not often enough, although its application seems clear in many investor cases. Broker-dealers and RIAs are undeniably required by law and regulation to protect their customers as a part of their business of providing advice. When they delegate that responsibility to representatives or anyone else, agent or not, the firms remain responsible for investment fraud and financial abuse that they are required to

prevent. Or at least the distinguished, scholarly lawyers comprising the American Law Institute seem to think so.

APPARENT AUTHORITY

The rules of apparent authority apply to both employee agents and nonemployees alike. They also apply to employees whose acts fall outside the scope of employment and can be a way around the "beyond the scope of employment" challenges arising under *respondeat superior*.

Apparent authority is defined in the Restatement (Third) at section 2.03 as "the power held by an agent or other actor to affect a principal's legal relations with third parties when a third party reasonably believes the actor has authority to act on behalf of the principal and that belief is traceable to the principal's manifestations." Section 3.03 provides that "Apparent authority, as defined in § 2.03, is created by a person's manifestation that another has authority to act with legal consequences for the person who makes the manifestation, when a third party reasonably believes the actor to be authorized and the belief is traceable to the manifestation."

Section 7.08 of the Third Restatement provides:

> A principal is subject to vicarious liability for a tort committed by an agent in dealing or communicating with a third party on or purportedly on behalf of the principal when actions taken by the agent with apparent authority constitute the tort or enable the agent to conceal its commission.

Apparent authority is what most practitioners first consider when drafting claims based on agency, because it has direct application to many investor cases. As comment a to Section 708 explains:

> The torts to which this section applies are those in which an agent appears to deal or communicate on behalf of a principal and the agent's appearance of authority enables the agent to commit a tort or conceal its commission. Such torts include fraudulent and negligent misrepresentations, defamation, tortious institution of legal proceedings, and conversion of property obtained by an agent purportedly at the principal's direction.

The value of apparent authority for investor cases is apparent from the illustrations provided in the Restatement (Third):

> 1. P Numismatics Company urges its customers to seek investment advice from its retail salespeople, including A. T, who wishes to invest in gold coins, seeks A's advice at an office of P Numismatics Company. A encourages T to purchase a particular set of gold coins, falsely representing material facts relevant to their value. T, reasonably relying on A's representations, purchases the set of coins. P is subject to liability to T. A is also subject to liability to T. See § 7.01.
>
> 2. Same facts as Illustration 1, except that A persuades T to pay cash for the coins and to leave the coins with A so that they may be safely stored by P Numismatics Company. A then absconds with both the coins and the cash paid by T. Same results.

Practitioners should look for manifestations that the representative was acting as agent for the firm. Tortious conduct that occurs in the firm's offices, through communications using the firm's email or letterhead are helpful. The existence of firm signage wherever the advisor conducts business, and the use of firm business cards are all factors to inquire into. Where the conduct occurred at the client's dining room table or in a car or restaurant, and without the use of the firm name in any way, the argument can become more challenging.

INHERENT AGENCY AUTHORITY

This might be the most overlooked of the types of agency customer cases. It is defined in the Restatement (Second) of Agency § 8A as "the power of an agent which is derived not from [actual] authority, apparent authority or estoppel, but solely from the agency relation and exists for the protection of persons harmed by or dealing with a servant or other agent."

An Oregon case illustrates its value in cases where a dishonest agent acting outside the scope of his authority is unavailable and plaintiff seeks to hold the principal responsible. In *Croisant v. Watrud*, 248 Or 234, 432 P.2d 799 (1967), plaintiff hired an accounting firm for tax advice and tax preparation. Thereafter, plaintiff sold her business and she began to rely on one of the accounting firm's partners, Watrud, to perform additional services beyond tax work, including the collection and disbursement of funds relating to periodic payments owing to plaintiff from the sale of her business. Watrud was caught making an unauthorized check payable to himself from plaintiff's funds, and approving checks payable to plaintiff's cheating husband, contrary to plaintiff's specific instructions. Watrud died, and plaintiff filed suit against the accounting firm where Watrud worked.

The court found that Watrud had neither express nor implied authority from the firm to commit his wrongful acts, since the acts were beyond the scope of services traditionally provided by accountants. However, relying on Restatement (Second) Section 8A, the court found that Watrud acted with inherent agency authority. The opinion states:

> When an agent has acted improperly in entering into a contract the inherent agency power 'is based neither upon the consent of the principal nor upon his manifestations.' The scope of the principal's liability under an inherent agency power is stated in Section 161:
>
> 'A general agent for a disclosed or partially disclosed principal subjects his principal to liability for acts done on his account which usually accompany or are incidental to transactions which the agent is authorized to conduct if, although they are forbidden by the principal, the other party reasonably believes that the agent is authorized to do them and has no notice that he is not so authorized.' Restatement (Second), Agency § 161, p. 378 (1958).

Croisant, 248 Or 239. In further explaining the reasoning for finding the accounting firm liable, the court quoted from Comment A to Section 219 of the Restatement (Second):

> [The principal's] liability exists solely because of his relation to the agent. It is based primarily upon the theory that, if one appoints an agent to conduct a series of transactions over a period of time, it is fair that he should bear losses which are incurred when such an agent, although without authority to do so, does something which is usually done in connection with the transactions he is employed to conduct. Such agents can properly be regarded as part of the principal's

organization in much the same way as a servant is normally part of the master's business enterprise.

Croisant, 248 Or at 241.

The Restatement (Third) does not recognize inherent authority, but neither is it outright rejected. Comment b to Section 2.01 says "The term 'inherent agency power,' used in Restatement Second, Agency, and defined therein by § 8A, is not used in this Restatement. Other doctrines stated in this Restatement encompass the justifications underpinning § 8A including the importance of interpretation by the agent in the agent's relationship with the principal, as well as the doctrines of apparent authority, estoppel, and restitution."

There are other cases that have recognized inherent agency authority and they are still good law. *See, e.g., Home Savings Ass'n v. General Electric Credit Corp.,* 708 P.2d 280 (Nev. 1985)(principal bound by agent's fraudulent acts where plaintiff has no knowledge of agent's improper conduct, even where agent acts for himself and without benefit to the principal*); AutoXchange. com, Inc. v. Dreyer and Reinbold, Inc*., 816 N.E.2d 40 (Ind. App.2004) (recognizing inherent authority and noting that "[w]hereas the focus of apparent authority is the reasonable belief of the third party, inherent authority refers to acts done on the principal's account which accompany or are incidental to transactions which the agent is authorized to conduct if, although they are forbidden by the principal, the third party reasonable believes that the agent is authorized to do them and has no notice that he is not so authorized.")

Not surprisingly, inherent agency authority has been subject to some criticism, but also has its supporters. *Compare* J.D. Ingram, "Inherent Agency Powers: A Mistaken Concept Which Should Be Discarded" (2004) 29 *Okla City U L Rev* 583 *with* M.P. Ward, "A Restatement or a Redefinition: Elimination of Inherent Agency Power in the Tentative Draft of the Restatement (Third) of Agency" (2002) 59 *Wash & Lee LR* 1585.

CATCH-ALL AGENCY RULES

Investor lawyers should also consider that the Restatement (Second) includes a catch all provision for when masters are liable for the conduct of their servants. Section 219(2) provides for liability where:

(a) the master intended the conduct or the consequences, or
(b) the master was negligent or reckless, or
(c) the conduct violated a non-delegable duty of the master, or
(d) the servant purported to act or to speak on behalf of the principal and there was reliance upon apparent authority, or he was aided in accomplishing the tort by the existence of the agency relation.

CONCLUSION

The law of agency be valuable to investor lawyers faced with the challenge of proving a firm's liability for the wrongful acts of its representatives. While it is beyond the scope of this short article to evaluate the law of every (or any) state, hopefully, this summary of some basic agency principles will give practitioners a good start in researching and understanding the law that governs their cases.

TEXAS	OREGON
STATUTES	
Texas Revised Civil Statute Article 581-33(F)(2) ("Civil Liability with Respect to Issuance or Sale of a Security") F. Liability of Control Persons and Aiders. (1) A person who directly or indirectly controls a seller, buyer, or issuer of a security is liable under Section 33A, 33B, or 33C jointly and severally with the seller, buyer, or issuer, and to the same extent as if he were the seller, buyer, or issuer, unless the controlling person sustains the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist. (2) A person who directly or indirectly with intent to deceive or defraud or with reckless disregard for the truth or the law materially aids a seller, buyer, or issuer of a security is liable under Section 33A, 33B, or 33C jointly and severally with the seller, buyer, or issuer, and to the same extent as if he were the seller, buyer, or issuer. (3) There is contribution as in cases of contract among the several persons so liable. ---------- Tex. Rev. Civ. Stat. Art. 581-33-1 ("Civil Liability of Investment Advisers and Investment Adviser Representatives") E. Liability of Control Persons and Assistants.	ORS § 59.115 ("Liability of seller to purchaser") (3) Every person who directly or indirectly controls a seller liable under subsection (1) of this section, every partner, limited liability company manager, including a member who is a manager, officer or director of such seller, every person occupying a similar status or performing similar functions, and every person who participates or materially aids in the sale is also liable jointly and severally with and to the same extent as the seller, unless the nonseller sustains the burden of proof that the nonseller did not know, and, in the exercise of reasonable care, could not have known, of the existence of facts on which the liability is based. Any person held liable under this section shall be entitled to contribution from those jointly and severally liable with that person. (4) Notwithstanding the provisions of subsection (3) of this section, a person whose sole function in connection with the sale of a security is to provide ministerial functions of escrow, custody or deposit services in accordance with applicable law is liable only if the person participates or materially aids in the sale and the purchaser sustains the burden of proof that the person knew of the existence of facts on which liability is based or that the person's failure to know of the existence of such facts was the result of the person's recklessness or gross negligence.

(1) A person who directly or indirectly controls an investment adviser is jointly and severally liable with the investment adviser under this section, and to the same extent as the investment adviser, unless the controlling person sustains the burden of proof that the person did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which liability is alleged to exist. (2) A person who directly or indirectly with intent to deceive or defraud or with reckless disregard for the truth or the law materially aids an investment adviser in conduct for which a cause of action is authorized by this section is jointly and severally liable with the investment adviser in an action to recover damages under this section.	
AIDING AND ABETTING / ASSISTANCE —SCIENTER / KNOWLEDGE	
"We conclude that the TSA's scienter requirement of "reckless disregard for the truth or the law" is similarly intended to impose a requirement of "recklessness in its subjective form," and this recklessness must be directly related to the primary violator's securities violation." ... "We therefore hold that the TSA's "reckless disregard for the truth or the law" standard means that an alleged aider can only be held liable if it rendered assistance "in the face of a perceived risk" that its assistance would facilitate untruthful or illegal activity by the primary violator. TEX. REV. CIV. STAT. ANN. art. 581–33F(2); *Kolstad,* 527 U.S. at 536, 119 S.Ct. 2118. In order to perceive such a risk, the alleged aider must possess a "	"ORS 59.115(3) makes one who is not himself the seller of a security liable for an unlawful sale if he "participates or materially aids in the sale." "Participate" and "materially aids" are separate concepts, not synonyms. A person may participate without materially aiding or materially aid without participating. Whether one's assistance in the sale is "material" does not depend on one's knowledge of the facts that make it unlawful; it depends on the importance of one's personal contribution to the transaction. Typing, reproducing, and delivering sales documents may all be essential to a sale, but they could be performed by anyone; it is a drafter's knowledge, judgment, and assertions reflected in the contents of the documents that are "material" to the sale. One passage in *Adams* referred to federal cases under ORS 59.115(3) (before its 1967 amendment) and under Section 10(b)

‘general awareness that his role was part of an overall activity that is improper.’ ” *Gould,* 535 F.2d at 780." ... "Ignoring internal procedures that might have alerted Sterling to Cornelius's scheme may be negligence, but it is not “reckless disregard for the truth or the law.”" *Sterling Tr. Co. v. Adderley*, 168 S.W.3d 835, 841-843 (Tex. 2005) ---------- Sitting on the board of a company does not impute personal knowledge of the corporation’s activities to that individual. *Highland Capital Management, L.P. v. Ryder Scott Co*., 402 S.W.3d 719, 739 (Tex. App. 2012).	of the Securities Exchange Act of 1934, 15 USC § 78j(b), and said, in passing, that “some statements in those opinions may be overly broad, if literally applied.” 265 Or. at 527–28, 510 P.2d 838. The quoted passage on its face only stated a possible question, not a conclusion. Perhaps more important, the *Adams* opinion (265 Or. at 530, 510 P.2d 838) observed that if a lawyer who prepared important documents and corporate minutes and supervised the printing of debentures were not covered by ORS 59.115(3), “any lawyer or anyone else who, with full knowledge of the unlawful ‘solicitation of an offer to purchase’ an unissued and unregistered security, proceeds to make the further arrangements necessary for issuance and delivery of such a security, would have a complete defense, regardless of whether the security was ever subsequently registered.” The point of the quoted sentence is that if such acts by a lawyer did not constitute “material aid” in the sale, the lawyer would not be liable even if he had full knowledge of the unlawful transaction. The sentence in no way implies that “material aid” depends on knowledge. Knowledge becomes an element of liability only in the form of an affirmative defense, to be proved by a nonseller, that he “did not know, and, in the exercise of reasonable care, could not have known, of the existence of the facts on which the liability is based.” The drafters took pains to make clear that the relevant knowledge is of “the existence of the facts,” not of the unlawfulness of a sale. These provisions may place upon persons besides a seller's employees or agents who materially aid in an unlawful sale of securities a substantial burden to exonerate themselves from liability for a resulting loss, but this legislative choice was deliberate. … The defense against strict liability, in short, was to be a showing of ignorance, not the professional role of the person who renders material aid in the unlawful sale. "

	Prince v. Brydon, 307 Or. 146, 149–51, 764 P.2d 1370, 1371–72 (1988) (reversing summary judgment for attorney who had drafted limited partnership agreement and portions of offering circular and provided opinion on partnership's tax status).
SUBSTANTIAL / MATERIAL ASSISTANCE	
In *Willis v. Marshall*, limited partners attempted to sue an accounting firm that prepared financial reports for the sale of partnership interests for aiding and abetting under the Texas securities laws, but that claim failed on summary judgment for lack of substantial assistance: "Marshall also asserts that Appellants failed to present evidence showing Marshall rendered substantial assistance in a primary violation of the TSA. We agree. The evidence clearly shows that Marshall's disclaimer letters to the partners warned: (1) that it had not audited or reviewed the financial statements comprising compilation, and explained that a compilation is the mere presentation of information that is the representation of management, upon which it did not express an opinion or any other form of assurance; (2) that management had elected to omit substantially all of the disclosures and the statement of cash flows required by generally-accepted accounting principles; and (3) that the inclusion of the information omitted by management may influence the user's conclusions about the company's financial condition. Moreover, there is no evidence that Marshall knew that Tuinei was selling securities to Appellants before March 2005. Because Appellants have failed to provide more than a scintilla of evidence raising a genuine issue of material fact, the trial court did not err in granting a no-evidence summary judgment on Appellants' TSA-violation claim. "	"The Oregon courts have given the emphasized language in ORS 59.115(3) a very broad and literal reading. In *Prince v. Brydon,* 307 Or. 146, 764 P.2d 1370 (1988), the court found that an Idaho attorney who prepared documents could be found to have materially aided and participated in a sale of a security. *See also Anderson v. Carden,* 146 Or.App. 675, 684, 934 P.2d 562 (1997) ("There is no question that a person who prepares documentation in connection with a sale of securities is a person who 'participates or materially aids' in the sale"). In *Ainslie v. First Interstate Bank,* 148 Or.App. 162, 939 P.2d 125 (1997) (*Ainslie II*), the Oregon Court of Appeals found that an escrow agent could be liable under the statute, and stated that proof of direct unlawful activity by a defendant "is not *essential* to establish its liability as a participant or material aider." *Ainslie II*, 148 Or.App. at 184, 939 P.2d 125. The "relevant knowledge is of 'the existence of the facts,' not of the unlawfulness of a sale." *Prince,* 307 Or. at 150, 764 P.2d 1370." *Mann v. St. Laurent*, 229 F. Supp. 2d 1133, 1138 (D. Or. 2002) A subordinate attorney providing legal services, such as using investor money to prevent a foreclosure threatening investment interests, without knowledge of facts making sale illegality, may constitute material aid in unlawful sale. *Ainslie v. Spolyar*, 144 Or. App. 134, 144-45 (Or. App. 1996).

Willis v. Marshall, 401 S.W.3d 689, 704–05 (Tex. App. 2013) --- Under Texas law, even if an accounting firm had a duty to withdraw from representation after discovering fraud but failed to do so, that would not constitute substantial assistance: " The Lessors also assert that Grant Thornton breached a duty to withdraw from its representation of ETS and Phoenix after it allegedly discovered the fraud by these companies. We presume for the sake of argument that Grant Thornton had such a duty to withdraw and breached this duty. Even under this presumption, Grant Thornton's failure to withdraw resulted only in the completion by Grant Thornton of the actions reflected in the evidence that we already have determined do not constitute substantial assistance as a matter of law. Therefore, any alleged breach by Grant Thornton of a duty to withdraw does not alter the conclusion of our analysis." *Navarro v. Grant Thornton, LLP*, 316 S.W.3d 715, 727 (Tex. App. 2010) (affirming trial court's grant of accounting firm's motion for summary judgment)	"It is not disputed that defendant Barton of the Nossaman firm prepared the legal papers necessary for Nova-Tech to complete the sale of its securities. Even if Barton did not know and could not have known of Nova-Tech's failure to register the securities, he was a participant in the sale because, without his assistance, the sale would not have been accomplished. Adamson v. Lang, *supra.* The other Nossaman defendants argue that they did not have a hand in the preparation of documents, but it is undisputed that the Nossaman firm authorized Nova-Tech to include its name as corporate counsel on Nova-Tech's 1968 and 1969 annual reports. In line with the Oregon court's broad construction of the Blue Sky Law, Adamson v. Lang, *supra,* I hold that the Nossaman firm's designation on Nova-Tech's published reports as Nova-Tech's corporate counsel is enough, for purposes of ORS 59.115(3) and 59.155, to make the firm's partners "participants" in any unlawful securities transaction in which the annual reports were used for promotional purposes." *Black & Co. v. Nova-Tech, Inc.*, 333 F. Supp. 468, 472 (D. Or. 1971); but see *Adams v. Am. Western Securities, Inc.*, 265 Or. 514, 527-28 (Or. 1973) (stating that the *Black* opinion "may be overly broad if literally applied").
CONTROL PERSON	
There is a split of authority regarding the degree of control required. The majority opinion appears to be the ability to control the ability to control the particular transaction at issue, but not actual involvement: "The *Frank* court determined a defendant is a control person under the TSA if it (1) exercised control over the operations of the corporation in general and (2)	"Evidence that a seller is a registered representative of an investment company and that the seller is licensed only through that company is sufficient to create a question of fact as to whether the company has the power to control the seller's transactions and is, therefore, liable under ORS 59.115(3). Our decision in *Ince v. AMEV Investors, Inc.,* 122 Or.App. 66, 857

had the power to control the specific transaction or activity upon which the primary violation is predicated." *Barnes v. SWS Fin. Servs., Inc.*, 97 S.W.3d 759, 764 (Tex. App. 2003); *Darocy v. Abildtrup*, 345 S.W.3d 129, 137 (Tex. App. 2011). But there is also authority indicating that actual involvement may be required as well: "The rationale for control person liability is that a control person is in a position to prevent the violation and may be able to compensate the injured investor when the primary violator is not. *Id.* The United States Fifth Circuit Court of Appeals has held that, to make a prima facie case that the defendant is a control person, a plaintiff must prove that each had actual power or influence over the controlled person and that each induced or participated in the alleged violation. *Dennis v. Gen. Imaging, Inc.,* 918 F.2d 496, 509 (5th Cir.1990); *G.A. Thompson & Co. v. Partridge,* 636 F.2d 945, 958 (5th Cir.1981)." *Texas Capital Sec. Mgmt., Inc. v. Sandefer*, 80 S.W.3d 260, 268 (Tex. App. 2002)	P.2d 165 (1993), *rev. den.,* 318 Or. 350, 870 P.2d 219 (1994), is on point. In that case, the defendant Kaneen was licensed to sell securities through the defendant AMEV, a broker-dealer. The investor sued Kaneen and AMEV, alleging, among other things, that AMEV was liable under ORS 59.115(3) for Kaneen's sales of unregistered securities. AMEV moved for, and obtained, summary judgment on the ground that there was no evidence that AMEV had actually participated in the sale of the securities. We reversed, holding that evidence that Kaneen was a registered salesperson who sold exclusively through AMEV was sufficient to raise a genuine issue of material fact as to whether AMEV had the power to control Kaneen. *Ince,* 122 Or.App. at 68–69, 857 P.2d 165. The same holds true in this case, in which plaintiff has produced evidence that, at the time the Immcon and Smith notes were sold to plaintiff, James Ritacco was licensed to sell securities through Andover and no one else. Plaintiff has shown the existence of a genuine issue of material fact as to whether Andover had the power to control James Ritacco when he sold the notes to plaintiff." *Castle v. Ritacco*, 142 Or. App. 89, 96–97, 919 P.2d 1196, 1199–200 (1996)

DISCOVERY ISSUING ARISING FROM THE SUSPICIOUS ACTIVITY REPORT PRIVILEGE

Glenn S. Gitomer, Esquire

I. THE SWORD

Discovery regarding red flags of money laundering or fraudulent activity may be critical to developing proof of a broker-dealer's liability in selling away and fraud cases. The duty of financial institutions to detect and monitor suspicious activity arises from the anti-money laundering ("AML") provisions of the Bank Secrecy Act, 31 U.S.C. §5311, *et seq.* FINRA Rule 3310, entitled Anti-Money Laundering Compliance Program, sets forth the requirements of broker-dealers to develop and implement a written AML program designed to monitor the member's compliance with the Bank Secrecy Act and the regulations promulgated thereunder.

FINRA Notice to Members 02-21 and Regulatory Notice 19-18 discuss broker-dealers' obligations under the Bank Secrecy Act and Rule 3310 to identify and report to the Financial Crimes Enforcement Network ("FinCEN") activity that a broker-dealer knows, suspects, or has reason to suspect involves the use of the broker-dealer to facilitate criminal activity. NTM 02-21 and RN 19-18 set forth a litany of red flags of suspicious activity that the member's implemented AML compliance program should be designed to detect.

As part of their obligations under FINRA Rule 3310, the supervisory and registered representative manuals of a broker-dealer invariably set forth the obligation to be cognizant of and report to the AML Compliance Officer ("AMLCO") suspicious or potentially fraudulent or money laundering activity. Broker-dealers also have manuals setting forth the duties of the AMLCO to independently identify suspicious activity and, under appropriate circumstances, make a suspicious activity report ("SAR") to FinCEN.

Discovery of a) manuals setting forth the obligations of registered representatives, branch managers, compliance officers and the AMLCO to identify and report suspicious activity; b) documents relating to the observation of suspicious activity; and c) documents relating to facts that should have raised red flags of suspicious activity may be helpful in establishing that the broker-dealer knew or should have known that its employees or customers were involved in fraudulent activity.

II. THE SHIELD

As a matter of course, broker-dealers may object to discovery requests seeking such discovery based upon a broad extension of the SAR privilege. The SAR privilege is based upon the regulation set forth in 31 C. F. R. § 1023.320, which requires broker-dealers to reports suspicious transactions to FinCEN. Subsection 1023.320(e) provides:

> (e) *Confidentiality of SARs.* **A SAR, and any information that would reveal the existence of a SAR, are confidential and shall not be disclosed except as authorized in this paragraph (e).** For purposes of this paragraph (e) only, a SAR shall include any suspicious activity report filed with FinCEN pursuant to any regulation in this chapter.

(1) *Prohibition on disclosures by brokers or dealers in securities.*

(i) *General rule.* **No broker-dealer, and no director, officer, employee, or agent of any broker-dealer, shall disclose a SAR or any information that would reveal the existence of a SAR.** Any broker-dealer, and any director, officer, employee, or agent of any broker-dealer that is subpoenaed or otherwise requested to disclose a SAR or any information that would reveal the existence of a SAR, shall decline to produce the SAR or such information, citing this section and 31 U.S.C. 5318(g)(2)(A)(i), and shall notify FinCEN of any such request and the response thereto.

(ii) *Rules of construction.* **Provided that no person involved in any reported suspicious transaction is notified that the transaction has been reported, this paragraph (e)(1) shall not be construed as prohibiting:**

(A) The disclosure by a broker-dealer, or any director, officer, employee, or agent of a broker-dealer, of:

(1) A SAR, or any information that would reveal the existence of a SAR, to FinCEN or any Federal, State, or local law enforcement agency, or any Federal regulatory authority that examines the broker-dealer for compliance with the Bank Secrecy Act; or to any SRO that examines the broker-dealer for compliance with the requirements of this section, upon the request of the Securities Exchange Commission; or

(2) **The underlying facts, transactions, and documents upon which a SAR is based**, including but not limited to, disclosures:

(i) To another financial institution, or any director, officer, employee, or agent of a financial institution, for the preparation of a joint SAR; or

(ii) In connection with certain employment references or termination notices, to the full extent authorized in 31 U.S.C. 5318(g)(2)(B); or

(B) The sharing by a broker-dealer, or any director, officer, employee, or agent of the broker-dealer, of a SAR, or any information that would reveal the existence of a SAR, within the broker-dealer's corporate organizational structure for purposes consistent with Title II of the Bank Secrecy Act as determined by regulation or in guidance.

(2) *Prohibition on disclosures by government authorities.* A Federal, State, local, territorial, or Tribal government authority, or any director, officer, employee, or agent of any of the foregoing, shall not disclose a SAR, or any information that would reveal the existence of a SAR, except as necessary to fulfill official duties consistent with Title II of the Bank Secrecy Act. For purposes of this section, “official duties” shall not include the disclosure of a SAR, or any information that would reveal the existence of a SAR, in response to a request for disclosure of non-public information or a request for use in a private legal proceeding, including a request pursuant to 31 CFR 1.11.

> (3) *Prohibition on disclosures by Self-Regulatory Organizations.* Any self-regulatory organization registered with the Securities and Exchange Commission, or any director, officer, employee, or agent of any of the foregoing, shall not disclose a SAR, or any information that would reveal the existence of a SAR except as necessary to fulfill self-regulatory duties with the consent of the Securities Exchange Commission, in a manner consistent with Title II of the Bank Secrecy Act. For purposes of this section, "self-regulatory duties" shall not include the disclosure of a SAR, or any information that would reveal the existence of a SAR, in response to a request for disclosure of non-public information or a request for use in a private legal proceeding.

31 C. F. R. § 1023.320(e) [emphasis added].

The vast majority of courts have interpreted the SAR privilege to prohibit the disclosure of documents that suggest, directly or indirectly, whether or not a SAR was filed with FinCEN. *In re JPMorgan Chase Bank, N.A.,* 799 F.3d 36, 43 (1st Cir. 2015). Courts will apply the SAR privilege if the documents at issue constitute a SAR or draft SAR, reflect the decision making process as to whether a SAR should be filed, the process of preparing a SAR, or an attempt to explain the content of a SAR. *Id.* at 44. Documents created in the ordinary course of business in monitoring unusual activity (as opposed to documents of an evaluative nature intended to comply with FinCEN reporting requirements), however, should not be subject to the SAR privilege. *Id, at 41.* "Any supporting documentation which would not reveal either the fact that a SAR was filed or its contents cannot be shielded from otherwise appropriate discovery based solely on its connection to an SAR." *Id.* at 44, citing *United States v. Holihan*, 248 F.Supp.2d 179, 187 (W.D.N.Y. 2003).

Broker-dealers require compliance officers, branch managers and registered representatives in the ordinary course of business to be aware of, inquire about, and report to the AMLCO suspicious or unusual activity. Documents relating to their observations of or inquiries into suspicious activity or their failure to identify red flags should not be prohibited by the SAR privilege and should be produced when requested in discovery. It is the responsibility of the AMLCO to decide whether to file a SAR. Only discovery seeking documents relating to the SAR itself or discovery relating to the deliberative process of the AMLCO in deciding whether to file a SAR are prohibited by the privilege.

III. SUPPORTING CASES

According to nearly every court that has addressed the issue, the SAR privilege only protects from disclosure SARs themselves, documents that would reveal whether a SAR was or was not filed, and documents relating to the evaluation of whether to file a SAR. *In re JPMorgan Chase Bank, N.A.*, 799 F.3d 36, 44 (1st Cir. 2015); *Ackner v. PNC Bank, N.A.*, No. 16-cv-81648, 2017 WL 1383950, at *2-3 (S.D. Fla. Apr. 12, 2017) (Fraud detection policies and procedures are not protected by the SAR privilege since the privilege only covers SARs and documents showing that a SAR has been filed); *Pershing LLC v. Kiebach*, No. 14-2549, 2017 WL 1284146 (E.D. La. Apr. 6, 2017) (Internal incident reports relating to suspicious activity created in the ordinary course of business are not protected by the SAR privilege because they do not indicate whether a SAR was created); *Wultz v. Bank of China Ltd.*, 56 F.Supp.3d 598, 601-02 (S.D.N.Y. 2014) (Investigatory documents and written policies directing what steps employees should take when they identify suspicious or unusual activity are not protected by the SAR privilege); *First American Title Ins. Co., v. Westbury Bank*, No.12-CV-1210, 2014 WL 4267450, at *2-3 (E.D. Wis. Aug. 29, 2014) (To be protected from disclosure under the SAR privilege, upon review of the document, one "must be able to discern with effective certainty the existence of a SAR."); *In re Whitley*, No. 10-10426C-

7G, 2011 WL 6202895, at *4 (Bankr. M.D.N.C. Dec. 13, 2011) (Documents relating to the investigation of suspicious activity that do not reveal the existence of a SAR are not protected by the SAR privilege); *Freedman & Gersten, LLP v. Bank of America*, No. 09-5351, 2010 WL 5139874, at *3 (D.N.J. Dec. 8, 2010) (Memoranda and documents drafted in response to suspicious activity (other than SARs or draft SARs), and policies and procedures relating to risk management and handling suspicious activity, are discoverable); *Gregory v. Bank One, Ind., N.A.*, 200 F.Supp.2d 1000, 1002 (S.D. Ind. 2002) (Only SARs and their contents are protected from disclosure, while supporting documentation and other reports of suspicious activity are not protected); *Weil v. Long Island Sav. Bank*, 195 F.Supp.2d 383, 389–90 (E.D.N.Y.2001) (Compelling the production of any "supporting documentation" that did not reveal the existence of a SAR or reveal its contents).

Incident reports and investigatory documents are not protected from disclosure by the SAR privilege unless they would specifically disclose whether a SAR has or has not been filed.

In *Pershing,* 2017 WL 1284146 at *2-3, the court held that summary reports prepared in the ordinary course of business as part of the process of internally investigating potential suspicious activity were not protected by the SAR privilege and that "detecting fraud is simply part of a financial institution's ordinary course of business." The court went on to explain, based upon the First Circuit's holding in *JPMorgan*, that the ultimately determinative inquiry is "whether any of [the] documents suggested, directly or indirectly, that a SAR was or was not filed." *Id.* at *3 (*quoting, JPMorgan*, 799 F.3d at 43-44). The court held that the summary reports were akin to incident reports and were not protected by the SAR privilege because, although they included an employee's thoughts and impressions about why activity appeared to be suspicious, they were "devoid of any information by which the reader can determine whether the matter identified therein progressed beyond the making of the report, much less whether an actual SAR was ever created. *Id.* at *3.

Similarly, the court in *Freedman,* 2010 WL 5139874 at *3, held that "documents and facts pertaining to the suspicious activity at issue in this matter, which were created in the ordinary course of business" are not protected by the SAR privilege. The court explained that "[a]lthough [the bank] may have undertaken an internal investigation in anticipation of filing a SAR, it is also a standard business practice for banks to investigate suspicious activity …." *Id.* As a result, the court ordered the production of any memoranda and documents created in response to the suspicious activity at issue, excluding only SARs and drafts of SARs. *Id.*

In *First American,* 2014 WL 4267450 at *1, the plaintiff sought documents related to certain "fraud alerts" related to the accounts at issue that the defendant bank may have received, including information automatically generated by the fraudulent transaction monitoring software. The court began by parsing the language of the federal regulation at issue, which only protects from disclosure "a SAR or any information that ***would*** reveal the existence of a SAR." *Id.* at *2 [emphasis added]. However, "information that, with the aid of supposition or speculation, might tend to suggest to a knowledgeable reviewer whether a SAR was filed, is not privileged." *Id.* at *3. The Court held that the use of the word "would" denotes that to be protected, one "must be able to discern with effective certainty the existence of a SAR" from the document. *Id.* at *2. The Court went on to hold that, "Simply because such facts may demonstrate that a bank was aware of a fraud that fit the requirements of a SAR, and a reasonable inference could be drawn that a bank will generally comply with federal regulations, this does not mean that such information 'would' reveal that the bank filed a SAR." *Id.* The Court went on to explain that "Not all means or methods a bank may use to detect fraud or other financial irregularity are privileged simply because they might culminate in a SAR", and "In most cases … the disclosure of supporting

documentation would not reveal the filing of a SAR, and such documentation cannot be shielded from otherwise appropriate discovery simply because it has some connection to a SAR." *Id.* (citations omitted). Moreover, since "detecting fraud is part of a bank's ordinary course of business," documents generated a part of this standard business practice of investigating potential fraud or other irregularities are discoverable" and this "remains true even if this fraud investigation parallels the process of preparing a SAR."

In *Wultz*, 56 F.Supp.3d at 600, the plaintiff sought documents generated as a result of the bank's process of identifying and investigating suspicious or unusual activity, which process sometimes culminates in the information being presented to a bank committee charged with deciding whether to file a SAR. The bank gathered more than 10,000 documents generated as a result of this process, although it was unclear to the court whether or not any of the 10,000 pages included documents emanating from such committee. *Id.* The bank argued that all of the documents were protected by the SAR privilege since they result from the implementation of the bank's policies and procedures for the filing of SARs. *Id.* After conducting an *in camera* review of the documents, the court concluded that none of the documents indicated whether a SAR was filed, even though "a person with knowledge of SARs might deduce that certain banking activity would (or would not) result in the filing of a SAR." *Id.* The court went on to explain that nothing in the regulation barred production of documents prepared by a bank as part of its process to investigate suspicious activity. *Id.* at 601. Citing to various other cases, including *First American, Freedman, Whitley*, and *Weil*, the Court held that the investigatory documents sought were fully discoverable, and that the bank has not pointed to any "documents regenerated at the decision-making stage that contain a discussion of SAR requirements and reflect [the bank's] decision-making process specifically as to whether to file a SAR." *Wultz*, 56 F.Supp.3d at 602.

In *JPMorgan*, 799 F.3d at 37, the only Circuit Court to interpret the SAR privilege, victims of a Ponzi scheme brought claims against a bank, claiming that the bank failed to detect and stop the fraud. The First Circuit held that none of the documents were protected by the SAR privilege because they were only lists and descriptions of transactions, or, with regard to a small subset of the documents at issue, were not SARs or draft SARs, did not reflect the decision-making process as to whether a SAR should be filed, did not discuss the process of preparing a SAR, and did not attempt to explain the content of a SAR post-filing. *Id.* at 44. The Court explained that "the key query is whether any of [the] documents suggest, directly or indirectly, that a SAR was or was not filed." *Id.* at 43. Thus, the Court rejected the bank's invitation to view the SAR privilege "as extending to any documents that might speak to the investigative methods of the financial institution." *Id.* at 44.

Lastly, in *Whitley*, 2011 WL 6202895 at *1, it was alleged that the debtor "was engaged in a Ponzi scheme whereby he defrauded investors from whom he obtained loans or investments by means of false representations that the funds would be invested in a manner that would result in high returns to investors." The debtor maintained a checking account at the subject bank. *Id.* The bankruptcy trustee sought documents relating to any investigation or inquiry by the bank of the debtor or his account, documents relating to any response to the investigation and the findings or observations, notes of the investigation, including references to any noted suspicious activity, and documents relating to any explanation the debtor may have given to the bank about his account activity. *Id.* at *2. The trustee also sought any suspicious activity reports made by the bank. *Id.* The Court analyzed the applicable federal regulation and case law and determined that although the SARs were protected by the SAR privilege, the other documents were discoverable because only SARs, documents that refer to a SAR having been filed, documents referring to information as being a part of a SAR, and documents revealing the preparation or filing of a SAR are protected. *Id.* at *3-4.

In accord are *Wiand v. Wells Fargo Bank, N.A.,* 891 F. Supp. 1214, 1217-1219 (M.D. Fla. 2013); *Rotstain v. Trustmark National Bank,* 2020 WL 1697990 (N.D. Texas 2020); *Erhart v. BOFI Holding, Inc.,* 2018 WL 5994417 (S.D. Cal. 2018); *Shapiro v. Wells Fargo Bank, N.A.,* 2018 WL 4208255 (S.D. Fla. 2018).

IV. THE FINANCIAL INDUSTRY'S POSITION

The principal argument advanced by the financial industry to resist discovery of its due course investigation of unusual or suspicious activity is that responsive documents are part and parcel of its evaluative process of making a decision whether to file a SAR. This argument is suggested by a 2010 FinCEN interpretation of the SAR privilege as barring the disclosure of "material prepared by the financial institution as part of its process to detect and report suspicious activity, regardless of whether a SAR ultimately was filed or not." 75 Fed. Reg. 75593, 75595 (December 3, 2010). The industry's suggestion that this should be taken to mean that the entire process of detecting or investigating suspicious activity in the ordinary course of business is an integral part of is evaluation of whether to file a SAR has not been accepted by the courts and is not derived from the regulatory language creating the SAR privilege.

In the recent case of *Federal Trade Commission v. Marcus,* 2020 WL 1482250 (S.D. Fla. 2020), a third-party bank argued that the receiver's request for AMLCO documents, with reference to whether a SAR was filed redacted, would disclose it processes and algorithms used to report suspicious activity, and, by implication, relate to the evaluative process of whether a SAR should be filed. The court denied the receiver's motion to compel, but, in doing so, reiterated the well-accepted proposition that the SAR privilege does prevent "disclosure of internal reports and memoranda that merely concern observations of suspicious activity unrelated to the process of complying with federal reporting requirements." *Id.* at *6.

In *Marcus*, the bank made the often-raised argument that disclosure of its general AML process and procedures, even protected by a confidentiality agreement, may leak out and give bad actors intelligence that may assist them in avoiding detection. 2020 WL 1482250. While the court in *Marcus* did not address this argument, which neither arises under nor is supported by the regulation creating the SAR privilege, the argument was rejected by the courts in *Ackner v. PNC Bank,* 2017 WL 1383950*; Wultz v. Bank of China, Ltd,* 56 F.Supp.3d 598*;* and *Freedman & Gersten, LLP v. Bank of America,* 2010 WL 5139874*.*

V. CONCLUSION

The challenge in obtaining discovery of observations of potentially suspicious activity is in persuading arbitrators, who may reticent to make difficult decisions in the face of a claim of a federally mandated privilege, to wade through complex arguments unfamiliar to them. The analysis required will involve *in camera* review of documents and careful review of the law, which is largely based on district court opinions and one First Circuit decision. Relevant discovery, however, is critical to proof of a broker-dealer's liability in fraud, selling away and aiding and abetting cases.

FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20070071330

To: **Department of Enforcement**
Financial Industry Regulatory Authority (FINRA)

Re: **Legent Clearing LLC, Respondent**
Member Firm
CRD No. 117176

Pursuant to NASD Rule 9216 of FINRA's Code of Procedure, Legent Clearing LLC (Legent) submits this Letter of Acceptance, Waiver and Consent (AWC) for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Legent alleging violations based on the same factual findings described herein.

I. ACCEPTANCE AND CONSENT

A. Legent hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

Background

Legent has been a member of FINRA or its predecessor, NASD, since June 4, 2002. Legent acts as a clearing broker offering its services to introducing broker/dealers on a fully disclosed basis from its main office located in Omaha, Nebraska. As a clearing firm, Legent performs order processing, settlement and record-keeping functions for introducing broker/dealers. These introducing broker/dealers do not maintain back-office facilities to perform these functions.

Relevant Prior Disciplinary History

Legent has been the subject of one formal disciplinary action by FINRA relevant to this matter. *See* AWC No. E0420040084 (fining Legent $40,000 for, among other things, SEC Rule 15c3-3 violations).

Overview

Legent failed to develop and implement a written anti-money laundering (AML) program reasonably designed to achieve and monitor its compliance with the requirements of the Bank Secrecy Act during the period of February 1, 2004 through November 30, 2006 (the relevant AML period). Legent's AML program was not tailored to the Firm's business and did not adequately provide documentation of the Firm's AML activities. Among other things, Legent's written AML program did not adequately consider the money laundering risks posed by its introducing firms, some of which were conducting high risk AML activities, such as penny-stock liquidations. Further, while Legent experienced rapid growth during the relevant AML period, it

did not provide adequate resources to its AML program to account for this growth. As a consequence, Legent failed to file a Suspicious Activity Report (SAR) in a number of instances in which there did not appear to be any legitimate purpose for the transaction. Moreover, while in some instances Legent may have discussed some of these transactions internally, it did not conduct an adequate investigation to determine that the transactions were not in fact suspicious. In addition, Legent failed to document any discussions it might have had or the reason for any decision that it might have made not to file a SAR.

Legent also failed to provide an adequate AML training program for new and existing employees. For new employees, Legent's training program was limited to *ad hoc* instruction from departmental supervisors and a two-page document explaining money laundering. For existing employees, Legent's training program was limited to a short PowerPoint presentation at the firm's annual compliance meeting.

Through these deficiencies, Legent failed to develop and implement an adequate written AML program, in violation of NASD Conduct Rules 3011(a), 3011(b), 3011(e) and 2110, and MSRB Rule G-41.

In addition, from at least June 2004 through October 2006 (the relevant Reg. T period), Legent improperly extended credit by permitting cash account customers to use the proceeds of unsettled sale transactions to fund subsequent purchase and sale transactions. Legent also improperly extended credit by permitting customers to use the proceeds of unsettled sale transactions to meet the requirement that all securities purchased in cash accounts be paid for within five days of purchase date, regardless of whether and when the securities were subsequently sold. Legent also failed to have adequate supervisory systems and procedures to ensure compliance with Regulation T. As a result, Legent violated Regulation T, Parts 220.8(a) and (b), promulgated pursuant to Section 7 of the Securities Exchange Act of 1934 (the Exchange Act), and NASD Conduct Rules 2110 and 3010.

Finally, Legent failed to prepare an accurate reserve computation calculation in February 2007 and April 2006. This violated SEC Rule 15c3-3 and NASD Conduct Rule 2110.

Facts and Violative Conduct

Legent's AML Violations

Background

Legent became a member of FINRA in 2002. At the beginning of the relevant AML period, Legent provided clearing services to nine introducing firms. By the end of the relevant AML period, a little more than two and a half years later, that number had grown to 50, in locations across the United States, including New York City, Chicago and Los Angeles.

Some of these introducing firms engaged in activities that were high risk for AML purposes, such as penny-stock transactions, liquidations of proceeds, and frequent journaling activity among

various accounts which apparently were unrelated. Legent provided clearing services to some firms that, in addition to engaging in these high-risk activities, also had significant disciplinary backgrounds.

For example, Legent cleared for Franklin Ross, Inc. (Franklin Ross). Franklin Ross was the subject of two enforcement proceedings brought by FINRA during 2001-2002, including one that charged Section 5 of the 1933 Securities Act and supervisory violations. Also during the relevant AML period, FINRA brought an action against Franklin Ross in March 2006, alleging certain omissions by the firm in a private offering. Pursuant to that proceeding, Franklin Ross was suspended from participating in any securities offerings for one year and fined $20,000, and the firm's president was suspended for 10 days from acting in any supervisory capacity. FINRA expelled Franklin Ross in 2007 for serious AML violations. *See* FINRA Press Release, November 5, 2007.

Legent also cleared for Salomon Grey Financial Corp. (Salomon Grey). The SEC charged Salomon Grey, and its President, Kyle Rowe, with fraud in connection with a market manipulation scheme, and sought a permanent injunction in a September 27, 2002 Complaint filed in the United States District Court for the District of Utah. In August 2004, FINRA found in a formal disciplinary proceeding that Salomon Grey and Rowe violated SEC Regulation M, along with NASD Conduct Rules 2710 and 2110. Salomon Grey and Rowe were fined $100,000, and Rowe was suspended in all capacities for two weeks. Ultimately, FINRA expelled Salomon Grey and barred Rowe in April 2006 for AML and other serious supervisory violations. *See* FINRA Press Release, April 27, 2006.

Still another introducing firm that had a disciplinary history, and for which Legent provided clearing services, was Blackwell Donaldson & Company (Blackwell Donaldson). From 1999 to 2002, prior to the relevant AML period, Blackwell Donaldson was the subject of at least three separate regulatory enforcement actions, including one in which the firm was fined $50,000 by the State of Oregon for, among other things, serious supervisory deficiencies relating to micro-cap stock transactions. In June 2006, FINRA brought an action against Blackwell Donaldson's Chief Executive Officer and Anti-Money Laundering Compliance Officer for his role in the firm's serious AML violations that occurred from March 2004 to August 2004, and suspended him for one year from acting in any supervisory capacity.[1]

NASD Conduct Rule 3011 and MSRB Rule G-41

NASD Conduct Rule 3011, which became effective on April 24, 2002, requires FINRA members to develop and implement a written AML program reasonably designed to achieve and monitor compliance with the requirements of the Bank Secrecy Act, 31 U.S.C. §5311, *et seq.*, and the regulations promulgated thereunder. Section (a) of this Rule directs member firms to establish and implement procedures reasonably designed to detect and cause the reporting of certain suspicious transactions. Section (b) requires firms to establish and implement procedures reasonably designed to achieve compliance with the Bank Secrecy Act. Section (e) requires firms

[1]Blackwell Donaldson filed a Form BDW in March 2005.

to provide relevant on-going training to appropriate personnel. FINRA has issued numerous communications to its members regarding the requirements of Rule 3011. *See* Notice to Members (NTM) 02-21 (April 2002), 02-47 (August 2002), 02-50 (August 2002), 02-78 (November 2002), 02-80 (December 2002), 03-34 (June 2003) and 06-07 (February 2006).

MSRB Rule G-41 contains similar requirements for those broker/dealers engaged in municipal securities transactions.

NASD Conduct Rule 3011(a) requires FINRA members to establish and implement policies and procedures "that can be reasonably expected to detect and cause the reporting of" suspicious transactions. On July 2, 2002, the Department of Treasury issued the regulation requiring suspicious transaction reporting for broker/dealers, 31 CFR §103.19(a)(1). It required all broker/dealers to file with Treasury's Financial Crimes Enforcement Network (FinCEN) "a report of any suspicious transaction relevant to a possible violation of law or regulation." Treasury's release stated that broker/dealers should determine whether activities and transactions raise suspicions by looking for "red flags." NTM 02-47 discussed Treasury's release, set forth the provisions of the final AML rule, and provided various examples of "red flags." This NTM further advised broker/dealers of their duty to file a SAR to report certain suspicious transactions.[2] Further, NTM 02-21 emphasized each firm's duty to detect "red flags" and, if it detected any, "perform additional due diligence before proceeding with the transaction." NTM 02-21, p. 10.

Legent's Failure to File SARS
Or Investigate Suspicious Activities

During the relevant AML period, Legent failed to file SARS in numerous instances as described below. Legent cleared certain penny-stock transactions that presented patterns that necessitated, at a minimum, further investigation by Legent. More importantly, in many instances these patterns should have led to a SAR filing. In these instances Legent did not undertake adequate further investigation, did not consider filing a SAR, and did not file a SAR. *See* NTM 02-47, pp. 2-3 (outlining circumstances pursuant to which broker/dealer must file a SAR); *see also In the Matter of Park Financial Group, Inc. and Gordon C. Cantley*, SEC Rel. No. 56902, Admin. Proc. File No. 3-12614, p.4 (SEC Dec. 5, 2007) ("The failure to file a SAR as required by 31 C.F.R. § 103.19 is a violation of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder."). Also significant, to the extent Legent undertook any investigation, or considered filing a SAR but ultimately decided not to do so, Legent failed to document such investigation or decision.

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[2]"Pursuant to the final rule, a broker/dealer must report a transaction on Form SAR-SF if 'the transaction involves $5,000 or more, is conducted or attempted to be conducted through the broker/dealer and appears to serve no business or apparent lawful purpose....'" NTM 02-47, p. 2. The obligation to file a SAR may arise from a single transaction or from a series of transactions that form a suspicious pattern of activity. *Id.* NTM 02-47 quoted FinCEN's release on the final rule relating to SARS, stating, "In its release adopting the final rule, FinCEN explicitly clarifies that 'if a broker/dealer determines that a series of transactions that would not independently trigger the suspicion of the broker/dealer, but that taken together, form a suspicious pattern of activity, the broker/dealer must file a suspicious transaction report.'"

Examples of these failures by Legent are described below.

Solucorp Industries Ltd.

During the relevant AML period, Legent failed to file a SAR relating to suspicious transactions involving the stock of Solucorp Industries Ltd. (Solucorp). Beginning in January 2005, Solucorp stock was journaled among numerous accounts cleared by Legent that had no apparent relationship with one another. At least one of the accounts was held by a former insider of Solucorp who had a securities disciplinary history. Legent's records did not show any evidence of any inquiry regarding the relationship between the accounts, or any investigation into the journaling activities or business purpose for the transactions.

Specifically, on January 6, 2005, a stock promoter, B.M.I., journaled 25,000 shares, worth $35,500, to an individual, R.G., through an account at a firm that cleared through Legent. On January 19, 2005, B.M.I. received 100,000 physical shares into its account. On February 16, 2005, B.M.I. journaled 25,000 shares, worth $42,750, to G.E.U.I. On February 17, 2005, Solucorp issued a press release regarding a purported business relationship with a new manufacturer for a subsidiary's products.

Later, in October 2005, a former insider of Solucorp engaged in several suspicious transactions. Specifically, on October 12, 2005, one day after Solucorp issued a press release regarding an agreement with a new manufacturer, the former insider, J.K., received 41,000 shares of Solucorp stock, valued at $71,750, by journal from R.M. On January 6, 2006, J.K. journaled 40,000 shares, valued at $54,800, to H.Mc.

Legent should have given heightened scrutiny to J.K.'s suspicious transactions. The SEC announced in a Litigation Release on August 25, 2003 that Solucorp had been enjoined from violating Section 10(b) and Rule 10b-5 pursuant to a March 12, 2003 Order entered by the United States District Court for the Southern District of New York. J.K. was expressly identified in that press release as an executive who "knowingly and deliberately falsified [press releases and financial statements] with the intention of deceiving shareholders and potential investors or, at the very least, [was] guilty of reckless disregard for the truth or falsity of the disclosures."

Legent also should have identified that all of the suspicious transactions were conducted through the same introducing broker/dealer. In fact, B.M.I, the stock promoter who received and journaled out shares, had the same business address as the business address for the introducing broker/dealer where the accounts were held.

Moreover, M.B., the President and Chief Compliance Officer of the introducing broker/dealer, also conducted certain suspicious transactions in Solucorp stock. On January 4, 2006, M.B. received 150,000 physical shares of Solucorp into his account. Further, on April 13, 2006, August 2, 2006, and September 28, 2006, M.B. received 100,000 physical shares of Solucorp into his account on each of these days.

These transactions were "red flags." There did not appear to be any legitimate business purpose for any of these transactions. Legent did not detect that the stock promoter had the same physical

address as the introducing broker/dealer. Legent also did not identify that J.K. was a former insider of Solucorp. Legent did not file a SAR relating to these transactions.

Broadband Wireless International Corp.

During the relevant AML period, Legent failed to file a SAR relating to suspicious transactions involving Broadband Wireless International Corporation (Broadband). Beginning in February 2004, Broadband stock was journaled among numerous accounts cleared by Legent that had no apparent relationship with one another. At least one of the accounts was held by an insider of Broadband. All of the suspicious transactions were conducted through the same introducing broker/dealer. Legent's records did not show any evidence of any inquiry regarding the relationship between the accounts, or any investigation into the journaling activities or business purpose for the transactions.

The suspicious transactions occurred between the accounts of individuals K.Mc. and M.D, and an entity known as B.C.M.C.I. K.Mc. was an officer and director of Broadband, and M.D. was identified as a consultant to Broadband.

On February 6, 2004, K.Mc. journaled 500,000 shares of Broadband, valued at $18,000, to B.C.M.C.I. through an account at a firm that cleared through Legent. On February 10, 2004, K.Mc. journaled 600,000 shares valued at $29,400 to B.C.M.C.I. Between February 6 and February 27, K.Mc. sold 500,000 Broadband shares for $25,427.74.

On March 5, 2004, M.D. journaled 3.2 million shares of Broadband, valued at $220,800, to B.C.M.C.I. On March 8, B.C.M.C.I. journaled 3 million shares, valued at $216,000, to an entity known as E.A.J.

Significant journaling activity of Broadband shares continued through the spring and into the summer of 2004. M.D. journaled 3 million shares to B.C.M.C.I. on March 18. B.C.M.C.I. journaled 2.5 million shares to E.A.J. on March 19. On April 14, M.D. journaled over 3 million shares to B.C.M.C.I. On May 5, K.Mc. received 1.6 million shares into his account. On June 10, K.Mc. received over 5 million physical shares into one account for which Legent provided clearing services, and also received 9 million shares in a different account cleared through Legent.

These transactions were "red flags." The Letters of Authorization requesting the transfers of shares of Broadband stock did not provide any reason for the journal activities, and did not explain any relationship between the parties. There did not appear to be any legitimate business purpose for any of these transactions. Legent did not detect that K.Mc. and M.D. had business relationships with Broadband, or that K.Mc. was an insider of Broadband. Legent did not file a SAR relating to these transactions.

American Energy Production

During the relevant AML period, Legent failed to file a SAR relating to suspicious transactions involving American Energy Production (American Energy). Beginning in March 2004,

American Energy stock was journaled among numerous accounts cleared by Legent that had no apparent relationship with one another. Several of these accounts were held by stock promoters. Legent's records did not show any evidence of any inquiry regarding the relationship between the accounts, or any investigation into the journaling activities or business purpose for the transactions.

Specifically, in March 2004 A.C.I., a penny-stock promoter, received 1.9 million shares of American Energy into its account, which were valued at approximately $117,500. This account was at a firm that cleared through Legent. In less than two weeks, A.C.I. journaled out of its account 1,442,500 shares of American Energy to three different parties which were apparently unrelated: A.I., W.S.C.F. and Ri.M. A.I., a penny-stock promoter, journaled out 260,000 shares of American Energy to W.S.C.F. from March 17-19, 2004.

Also, in March 2004 W.S.C.F., yet another stock promoter, sent four wire transfers from its account cleared by Legent to various unidentified bank accounts, while A.I. sent two wire transfers to various unidentified bank accounts. These suspicious transactions occurred at the same time that American Energy was issuing press releases that provided significant favorable news for the company.

These transactions were "red flags." There did not appear to be any legitimate business purpose for any of these transactions. All of these accounts were held at Blackwell Donaldson, which had a relevant disciplinary history and a high incidence of high-risk transactions. Legent did not file a SAR relating to these transactions.

American Multiplexer Corp.

During the relevant AML period, Legent failed to file a SAR relating to suspicious transactions involving American Multiplexer Corp. (American Multiplexer). Beginning in March 2004, American Multiplexer was journaled among several accounts cleared by Legent that had no apparent relationship with one another, including accounts held by stock promoters A.C.I. and A.I. Legent's records did not show any evidence of any inquiry regarding the relationship between the accounts, or any investigation into the journaling activities or business purpose for the transactions.

Specifically, on March 4, 2004, A.C.I. received 250,000 shares into its account. On March 9, American Multiplexer issued a press release regarding the alleged formation of a retail distribution partnership with Amazon.com. On March 10, A.C.I. sold 30,000 shares for $12,963.46, and on March 17 A.C.I. sold an additional 42,500 shares of American Multiplexer, worth $17,934.28. On March 11, A.C.I. journaled 97,500 shares to A.I. A.I. sold the same number of shares on March 17 as A.C.I. had sold (42,500) and received the same price ($17,934.28).

On May 19, 2004, A.I. journaled 50,000 shares to A.C.I. and also journaled 200,000 shares, valued at $72,000, to another stock promoter, M.V.C. On June 1, A.I. and A.C.I. each journaled 50,000 shares apiece to M.V.C. This 100,000 share transfer to M.V.C. was worth $27,000.

On June 1, American Multiplexer issued another press release regarding its appointment of an additional authorized distributor of its product line, and on June 23 issued another press release. On June 23, A.I. journaled an additional 350,000 shares to A.C.I. In June and July 2004, A.C.I. and A.I. each sold 215,000 shares.

These transactions were "red flags." There did not appear to be any legitimate business purpose for any of these transactions. All of these accounts were held at Blackwell Donaldson, which had a relevant disciplinary history and a high incidence of high-risk transactions. Legent did not file a SAR relating to these transactions.

Paragon Financial Corp.

During the relevant AML period, Legent failed to file a SAR relating to suspicious transactions involving Paragon Financial Corp. (Paragon). Beginning in September 2004, Paragon stock was journaled among numerous accounts cleared by Legent that had no apparent relationship with one another. At least one of the accounts was held by an insider of Paragon. Legent's records did not show any evidence of any inquiry regarding the relationship between the accounts, or any investigation into the journaling activities or business purpose for the transactions.

Specifically, the suspicious Paragon transactions involved C.L., a former officer of Paragon and a greater-than-5% shareholder in the company. Paragon reported, on a Schedule 14A filed with the SEC in April 2004, that C.L. had ceased being an executive of the company. However, the April 2004 Schedule 14A disclosed that C.L. had an 11.1% ownership interest in Paragon, and a June 2005 Schedule 14A disclosed that C.L. had a 9.3% ownership interest in Paragon. On September 22, 2004, C.L. journaled 630,000 shares of Paragon, valued at approximately $88,200, to three different individuals. On January 5, 2005, C.L. journaled another 125,000 shares to one of the three individuals, worth about an additional $5,000.

These transactions were "red flags." There did not appear to be any legitimate business purpose for any of these transactions. Legent did not detect that C.L. was an insider of Paragon. Legent did not file a SAR relating to these transactions.

Infinicall Corp.

During the relevant AML period, Legent failed to file a SAR relating to suspicious transactions involving Infinicall Corp. (Infinicall). Beginning in August 2005, Infinicall stock was journaled to accounts cleared by Legent that had no apparent relationship with one another. At the center of the journaling activity was an account held in the name of an insider of Infinicall, J.T. While Legent initially questioned the introducing broker/dealer about J.T. and his transactions in Infinicall stock, Legent did not conduct a reasonable follow-up inquiry on the matter to verify that the transactions had a legitimate business purpose.

Specifically, the suspicious Infinicall transactions involved J.T. and T.E.G.L. J.T. was listed, in various Infinicall SEC filings made from June 2005 to February 2006, as Interim Chief Financial Officer, Director and Secretary of Infinicall. J.T. was also listed as the Assistant Secretary and Attorney for T.E.G.L.

On July 29, 2005, T.E.G.L. received 10,216,607 shares of Infinicall stock in its account, which Legent cleared. T.E.G.L. journaled 8,825,000 shares of this stock, valued at approximately $259,825, to five apparently unrelated accounts from August 2005 through March 2006.

Legent initially asked the introducing broker/dealer about the business purpose of the transactions, and noted that J.T. had an affiliation with Infinicall. The introducing broker/dealer responded that there was a "business relationship between these customers" and the introducing firm's belief that the customers were "compensated in stock instead of cash."

Legent was unable to demonstrate that it conducted any follow-up to determine what the relationship was among the parties to these transactions, or the business purpose of the transactions. Legent could not demonstrate that it requested documentation directly from the customers or the introducing broker/dealer.

J.T. later requested, pursuant to a December 12, 2005, Letter of Authorization, the transfer of an additional 600,000 shares of Infinicall to N.L. Again, no inquiry was conducted to ascertain the business purpose of the journals.

These transactions were "red flags." There did not appear to be any legitimate business purpose for any of these transactions. While Legent initially detected that J.T. may have been an insider of Infinicall, it did not conduct a reasonable follow-up investigation to ascertain the business purpose of the activities or the relationship between the parties. Legent did not file a SAR relating to these transactions.

Legent's foregoing conduct violated NASD Conduct Rules 3011(a) and 2110 and MSRB Rule G-41.

Legent's Failure To Timely File SARS

While Legent filed some SARS during the relevant AML period, in several instances it did so many months after the inception of suspicious conduct. For instance, in one SAR filing Legent identified that the suspicious activity had commenced nearly 16 months before the SAR was filed.

Such delay in filing SARS is inconsistent with guidance provided by FinCEN and FINRA. As discussed in NTM 02-47, p. 4, "Broker/dealers must file Form SAR-SF within 30 days of becoming aware of the suspicious transaction. If the broker/dealer is unable to identify a suspect, the rule provides an extra 30 days for filing the Form SAR-SF." *See also The SAR Activity Review, Trends, Tips & Issues*, Issue 10, p. 45 (May 2006) ("The time period to file a SAR starts when the institution, in the course of its review or as a result of other factors, reaches the conclusion in which it knows, or has reason to suspect, that the activity or transactions under review meets one or more of the definitions of suspicious activity. The 30-day . . . period does not begin until an appropriate review is conducted and a determination is made that the transaction under review is `suspicious' within the meaning of the SAR regulations.").

Legent's foregoing conduct violated NASD Conduct Rules 3011(a) and 2110 and MSRB Rule G-41.

Legent's AML Program and Written Procedures Were Inadequate

Legent's AML program and written procedures were inadequate for a number of reasons. For instance, the procedures were not specifically tailored to Legent's particular business model. FINRA NTM 02-21 emphasized that firms should not use a "one-size-fits-all" approach in crafting an AML program and procedures. Moreover, the resources that Legent committed to its AML program did not keep pace with the firm's rapid growth during the relevant AML period.

Some of the introducing firms for which Legent provided clearing services engaged in a significant number of transactions that were high risk for AML purposes, such as penny-stock transactions, liquidation of proceeds, and frequent journaling activity among various accounts which were apparently unrelated. Some of these same firms had securities industry disciplinary histories.

As a clearing firm, Legent was obligated to consider the money laundering risks posed by the introducing firms with which Legent did business, including information Legent obtained in the course of its relationship with the introducing firm. *See* FinCEN Guidance, FIN-2006-G009, p.2 (May 10, 2006) ("In a relationship with an introducing firm, a clearing firm must consider the money laundering risks posed by the introducing firm, including any information the clearing firm acquires about the account base of the introducing firm in the ordinary course of its business and through the application of its anti-money laundering policies, procedures, and controls."). Legent did not adequately consider these risks in its AML program, or in actual practice.

FINRA has provided examples of "red flags" for money laundering including, but not limited to, the following:

- The customer engages in excessive journal entries between related accounts without any apparent business purpose, or,

- The customer, for no apparent reason or in conjunction with other 'red flags,' engages in transactions involving certain types of securities, such as penny stocks....

NTM 02-21, pp. 10-11.

Legent's AML program and written procedures did not adequately identify these "red flags" and risks. Instead, for much of the relevant AML period, Legent simply imported text from FINRA's AML program Small Firm Template and did not tailor the Template to its business. By doing so, Legent did not account for the unique AML risks it faced.

Legent updated its AML written procedures near the end of the relevant AML period, in August 2006, and for the first time expressly recognized in them one of the major AML risks it faced as a clearing firm – the journaling and transferring of assets by its introducing firms' customers.

While the August 2006 procedures acknowledged this risk, they did not adequately address the surveillance of introducing firms' customer accounts for suspicious journaling activity.

Further, Legent's AML program and written procedures were inadequate because they lacked many necessary details. FINRA has provided guidance to the industry, directing that AML written procedures "must establish and implement controls and written procedures that explain the procedures that must be followed, the person responsible for carrying out such procedures, how frequently such procedures must be performed, and how compliance with the procedures should be documented and tested." FINRA NTM 02-21, p. 5.

For instance, each of the firm's written procedures in effect during the relevant AML period generally required the use and review of exception reports to monitor account activity. However, until August 2006, none of the written procedures actually identified or described any of the exception reports to be reviewed, nor did they describe the process to be used in reviewing these reports. Several versions required documentation of the review without describing how or where the review was to be documented, while other versions did not require documentation at all. The procedures did not assign responsibility to specific people, but instead required the review to be done by unspecified "Operations personal [sic], Traders, and the Anti-Money Laundering Compliance Officer." Legent's December 2005 independent audit discovered this deficiency and recommended adding specific details and descriptions, but Legent did not follow the recommendation until near the end of the relevant AML period.

Legent's AML procedures also did not specify how Legent's department heads were to use "desk procedures" created by the departments. The "desk procedures" were essentially step-by-step guidelines on how the departments were to conduct their functions to comply with broker/dealer regulatory requirements. However, the "desk procedures" were not tailored to address AML issues, and were not reviewed or drafted by Legent's Anti-Money Laundering Compliance Officer (AMLCO).

Legent's foregoing conduct violated NASD Conduct Rules 3011(a)-(b) and 2110 and MSRB Rule G-41.

The Firm's AML Training Program was Deficient

Legent's AML training program during the relevant AML period was deficient. At the beginning of the relevant AML period, Legent did not provide any uniform AML training for its new employees. Instead, Legent relied on its departmental supervisors to give new employees whatever AML training a particular supervisor deemed necessary. There were no controls or procedures in place to ensure that AML training was provided. Legent's AMLCO did not take part in the training that the departmental supervisors were providing to their new employees.

In approximately December 2005, Legent began giving new employees a two-page document that provided a brief explanation of the Patriot Act, money laundering and AML. New employees would receive this two-page document, along with other new employee forms and documents, on their first day of work at Legent. There still was no training provided by or supervised by the AMLCO or compliance department, or a senior officer of Legent. FINRA has advised member

firms that "[t]he AML employee training should be developed under the leadership of the AML Compliance Officer or senior management." NTM 02-21, p. 14. The foregoing process for training new employees existed through the end of the relevant AML period, and into January 2007.

As for existing employees, Legent's training occurred at its annual compliance meeting, and consisted of a short PowerPoint presentation made by the AMLCO. Legent provided no additional, focused, AML training to employees who had specific AML responsibilities. This level of training was not sufficient, given the types of business for which Legent was providing clearing services.

Legent's foregoing conduct violated NASD Conduct Rules 3011(e) and 2110 and MSRB Rule G-41.

Legent's Regulation T Violations

The Application of Regulation T to Cash Accounts

Legent violated Regulation T by failing to ensure (i) that securities were fully paid for prior to sale and (ii) that securities were fully paid for within two days of settlement.

In Cash Accounts, Payment for Securities is Required Prior to Sale

Section 7(c) of the Exchange Act provides that:

> It shall be unlawful for any member of a national securities exchange or any broker or dealer, directly or indirectly, to extend or maintain credit or arrange for the extension or maintenance of credit to or for any customer – on any security (other than an exempted security) ... in contravention of the rules and regulations which the Board of Governors of the Federal Reserve System ... shall prescribe.

Part 220.8(a) of Regulation T provides in relevant part:

(a) *Permissible Transactions.* In a cash account, a creditor, may:

(1) Buy for or sell to any customer any security or other asset if:

(i) There are sufficient funds in the account; or

(ii) The creditor accepts in good faith the customer's agreement that the customer will promptly make full cash payment for the security or asset before selling it and does not contemplate selling it prior to making such payment.

(2) Buy from or sell for any customer any security or other asset if:

> (i) The security is held in the account; or
>
> (ii) The creditor accepts in good faith the customer's statement that the security is owned by the customer or the customer's principal, and that it will be promptly deposited in the account ....

In transactions between a principal disclosed clearing firm and an introducing broker, the clearing firm is responsible for Regulation T compliance, because it is considered the creditor that extends the credit. *See* Fed. Res. Staff Op., 2 Federal Reserve Regulatory Services, Part 5-615.971 (Apr. 19, 1991). Under Regulation T, securities may be purchased in a cash account only if the customer has sufficient funds in the account to pay for the purchase, independent of the proceeds to be received from the subsequent sale of those securities. *See, e.g.,* Fed. Res. Staff Op., 2 Federal Reserve Regulatory Services, Part 5-616.11 (May 27, 1994). Additionally, the sale of a security to pay for another security purchased on the same date does not give rise to sufficient funds in the account by the applicable deadline. *See, e.g.,* Fed. Res. Staff Op., 2 Federal Reserve Regulatory Services, Part 5-616.14 (Feb. 18, 1999). *See also* Fed. Res. Staff Op., 2 Federal Reserve Regulatory Services, Part 5-616.15 (Jan. 6, 2000); Fed. Res. Staff Op., 2 Federal Reserve Regulatory Services, Part 5-615.971) (Apr. 19, 1991).

A Federal Reserve Board staff opinion addressed a situation in which a customer sells Stock A on Day 1, buys Stock B on Day 2, sells Stock B on Day 3, and then buys and sells Stock C on day 5. Fed. Res. Staff Op., 2 Federal Reserve Regulatory Services, Part 5-616.18 (May 12, 2003). The fact pattern assumed that all of the individual purchases cost less than the "account balance" and that Stock A had been paid for before it was sold on Day 1. The Board staff stated that Regulation T allows two methods for paying for a securities purchase in a cash account: (1) a customer who has sufficient funds in the account on trade date may purchase securities and sell them at any time; and (2) a customer who does not have sufficient funds in the account on trade date may purchase securities with the understanding that such securities will not be sold until they are paid in full. The opinion emphasized that sale proceeds that had not yet been received do not constitute "sufficient funds."

Under the facts presented in the foregoing example, the staff opinion stated that the sale of Stock B on Day 3 was inconsistent with the agreement that the customer will promptly make full cash payment for the security or asset before selling it and does not contemplate selling it prior to making such payment. The opinion also concluded that the sale of Stock B on Day 3, before the cash to pay for it was received, should put the broker/dealer on notice that the customer has engaged in a transaction that is not permissible in the cash account. The opinion further stated that the purchase of Stock C on Day 5 would therefore also have to be made pursuant to section 220.8(a)(1)(ii), with the result that the sale of Stock C on Day 5 was also a transaction that is not permissible in the cash account. The opinion noted that this interpretation did not set forth a new legal proposition, explaining that for over 50 years, Regulation T has required customers to pay for securities purchased in a cash account before selling them.

NASD issued Notice to Members 04-38, *Credit Extension/Day Trading Requirements* (May 2004) stating as follows:

> [Federal Reserve Board] interpretations make clear that a customer who sells a security on trade date to pay for another security purchased on that day does not have "sufficient funds in the account" on trade date for purposes of Reg T Section 220.8(a)(1)(i). Rather a customer must make full payment for each separate purchase transaction in a cash account without regard to the unsettled proceeds of securities sold. If a member firm plans to accept the unsettled proceeds of a securities sale as payment for securities purchased, the transaction must be conducted in a margin account, subject to the regulations affording protection to customers who trade in margin accounts. [Citations omitted]

In Cash Accounts, Payment for Securities is Required within Two Days of Settlement

Part 220.8(b) of Regulation T provides the time periods when payment for securities purchase must be made and states in relevant part:

(b) *Time periods for payment; cancellation or liquidation –*

(1) *Full cash payment.* A creditor shall obtain full cash payment for customer purchases:
(i) Within one payment period of the date:

(A) Any nonexempted security was purchased.

In turn, Part 220.2 defines "payment period" to mean "the number of business days in the standard securities settlement cycle in the United States ... plus two business days."

In a Federal Reserve Board Staff Opinion dated September 30, 1986, the staff addressed the question of whether a customer can "use sale proceeds of one security to pay for the purchase of a different security, so long as the trade date of the sale is on or before the settlement date of the purchase transaction." Fed. Res. Staff Op., Part 5-615.94 (Sept. 30, 1986). The staff answered the question by writing, "No, since the sale transaction will not settle until after settlement of the purchase transaction, there are insufficient funds in the account on settlement date. In addition, an extension of time could not be granted by a self regulatory organization in this case because there is no acceptable reason for an extension under Section 220.8(d)." *Id.*

The Violations

During the relevant Reg. T period, Legent effected improper trades by permitting customers to sell securities in cash accounts before making full cash payment in violation of Regulation T on numerous occasions. In one month alone, there were 77 violations, and the practice continued for 29 months. Additionally, Legent failed to properly restrict accounts from trading subsequent to this activity.

During the relevant Reg. T period, Legent also failed to ensure that, for each transaction in a cash account, full cash payment was made within two days of the settlement of such purchase, regardless of whether or when the security was sold. Specifically, the firm failed to fully and properly monitor whether proceeds from the sale of one security would settle before the payment deadline set forth in Part 220.8(b) of Regulation T for the purchase of a different security. The firm's procedures permitted it to improperly consider the purchase of one security in an account with insufficient cash to be timely paid for as long as the settlement of proceeds from the sale of another security of equal or greater value was pending at the time of the payment deadline. Part 220.8(b) of Regulation T prohibits such consideration of unsettled proceeds as cash payment.

Legent failed to adequately supervise transactions in securities in cash accounts to determine (i) whether securities were fully paid for prior to sale and (ii) whether securities were fully paid for within two days of settlement. Additionally, Legent's written supervisory procedures did not adequately address the provisions of Regulation T as described above. As a result, customers were permitted to sell securities before they were fully paid.

The foregoing acts, practices and conduct by Legent constitute separate and distinct violations of Regulation T and NASD Conduct Rules 2110 and 3010.

Legent's SEC Rule 15c3-3 Violations

Legent failed to make an accurate reserve computation as of February 28, 2007. Legent failed to include an amount in Item 3 of the reserve formula, thereby understating total credits by $4,783,010.91. Based on that computation, Legent withdrew $2,000,000 from its special reserve account on March 2, 2007. Legent subsequently recomputed the reserve computation as of February 28, 2007, and determined that the excess of total credits over total debits was $6,056,683.75. This created a special reserve account deficiency of $4,406,374.32 and, after some additional modifications were made to the computation, the total special reserve account deficiency was $4,434,754.32.

Legent also failed to make an accurate reserve computation as of April 28, 2006. This related to the firm having unduly concentrated margin balances in three customer accounts. Legent excluded these items from the computation on the basis that they related to a commingled customer loan, which was a credit item in the reserve formula. Legent erroneously offset the required reductions in debits by attempting to demonstrate that the securities pledged were included as collateral for a commingled loan. However, under the circumstances, individual loans needed to be established for each account to demonstrate that the debits were directly related to a credit item in the reserve formula. Further, the firm failed to obtain approval from its designated examining authority to permit the concentrated debit balances to be included in its reserve computation formula. This reduced customer debits by $13,880,931, and led to a reserve computation deficiency of $5,842,596 as of April 28, 2006.

Legent's conduct violated SEC Rule 15c3-3 and, consequently, NASD Conduct Rule 2110.

B. Legent also consents to the imposition of the following sanctions:

A censure and monetary fine of $350,000.

Legent specifically and voluntarily waives any right to claim that Legent is unable to pay, now or at any time hereafter, the monetary sanctions imposed in this matter. Legent has submitted an Election of Payment form showing the method by which Legent proposes to pay the fine imposed.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II. WAIVER OF PROCEDURAL RIGHTS

Legent specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

A. To have a Formal Complaint issued specifying the allegations against Legent;

B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;

C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and

D. To appeal any such decision to the National Adjudicatory Council (NAC) and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Legent specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Legent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of NASD Rule 9143 or the separation of functions prohibitions of NASD Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III. OTHER MATTERS

Legent understands that:

A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs (ODA), pursuant to NASD Rule 9216;

B. If this AWC is not accepted, its submission will not be used as evidence to prove any of

the allegations against Legent; and

C. If accepted:

1. this AWC will become part of Legent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against Legent;

2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about Legent's disciplinary record;

3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-3; and

4. Legent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Legent may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Legent's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

D. Legent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Legent understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

Legent certifies that Legent has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that Legent has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce Legent to submit it.

LEGENT CLEARING LLC

Date: 8/3/08

By: Craig Stack

Title: CCO

Reviewed by:

Attorney Name
Counsel for Respondent Legent

Firm Name Joseph D. Edmondson Jr. / Foley & Lardner LLP
Address 3000 K Street, N.W., Suite 500
City/State/Zip Washington, DC 20007
Phone Number 202-672-5354

Accepted by FINRA:

_____
Date

Signed on behalf of the Director of ODA,
by delegated authority

_____
Katherine A. Malfa
Vice President and Chief Counsel
FINRA Department of Enforcement
1801 K Street, NW
8th Floor
Washington, DC 20006
(202) 974-2853

_____
Jeffrey A. Ziesman
Senior Regional Counsel
FINRA, Kansas City District
120 West 12th Street, Suite 800
Kansas City, MO 64105
(816) 802-4712

FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2009018985203

TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

RE: Raymond James Financial Services, Inc., Respondent
CRD No. 6694

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Raymond James Financial Services, Inc. ("RJFS") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against RJFS alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

A. RJFS hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

RJFS is a FINRA registered broker dealer with approximately 4,749 registered persons and approximately 2,372 branch offices. RJFS, which is one of three broker dealer subsidiaries of Raymond James Financial, Inc., utilizes an independent contractor business model. RJFS introduces accounts to an affiliated company.

RELEVANT DISCIPLINARY HISTORY

RJFS has no relevant disciplinary history.

OVERVIEW

This matter involves the failure of RJFS to implement procedures that were reasonably designed to detect and cause the reporting of suspicious transactions in the accounts of its customer, JR. JR used his brokerage accounts at RJFS to conduct a Ponzi scheme that

resulted in losses of approximately $17.8 million to the individuals who provided funds to him.

Between January 5, 2005 and July 11, 2007 (the "relevant time period"), RJFS became aware of numerous red flags suggesting that JR may have been engaged in suspicious or illegal activity. However, RJFS failed to adequately consider or review many of these red flags in light of its Anti-Money Laundering obligations. In many instances, the information about the red flags was not provided to the firm's AML Officer for consideration and evaluation. After RJFS became aware of a suspicious flow of funds in and out of JR's accounts, it still failed to conduct adequate due diligence or monitoring of JR's accounts.

By failing to implement policies and procedures that were reasonably designed to detect and cause the reporting of suspicious transactions in the accounts of JR, RJFS violated NASD Rule 3011(a), and, by virtue of that violation, NASD Rule 2110.

FACTS AND VIOLATIVE CONDUCT

Facts

During the relevant time period, JR conducted a Ponzi scheme using his accounts at RJFS. That scheme resulted in losses of over $17 million to his "investors." JR accomplished this, in part, by periodically transferring funds to his RJFS brokerage accounts and then writing monthly checks to his supposed "investors" from his brokerage-linked money market account. Many of the checks were for identical, round-dollar amounts each month.

On July 6, 2007, the Ohio Division of Securities filed a complaint to place JR's assets, including his accounts at RJFS, into receivership. On July 17, 2007, JR pleaded guilty to first degree felonies for selling unregistered securities, perjury, and forgery. JR was sentenced to 20 years in prison and ordered to pay $17.8 million in restitution to approximately 200 victims who had provided him with funds.

RJFS Failed To Devote Adequate Resources to Its AML Program

RJFS's Anti-Money Laundering procedures provided that any employee of the firm who became aware of "any red flag, or other activity that may be suspicious" was to "notify the AML Officer." The procedures also provided that RJFS's AML Officer had "full responsibility for the firm's AML program," and was responsible for "develop[ing], administer[ing], and enforce[ing] policies and procedures designed to comply with U.S. AML rules and regulations."

The RJFS AML Officer's specific responsibilities also included, among others, reviewing AML exception reports for suspicious activity, filing Suspicious Activity Reports, communicating with Branch Managers regarding client actions, and conducting risk assessments of any incoming subpoenas concerning client accounts. The AML Officer

was also responsible for reviewing approximately 15 lengthy exception reports to identify potentially suspicious activity.

The RJFS branches were staffed with independent contractors. RJFS's AML program placed considerable reliance on the RJFS AML Officer's review of exception reports to detect suspicious activity at the branches. These exception reports generally covered only particular time periods, such as the preceding 30 or 90 days. In spite of the importance that the exception reports played in RJFS's AML program, RJFS did not maintain a database or other means of combining and reflecting information generated by multiple reports.

RJFS did not devote adequate resources to its AML program in light of limitations in its review processes. The AML Officer was responsible for, among other things, overseeing the AML program with respect to more than 2,000 independent contractor offices, manually reviewing 15 weekly and monthly exception reports for suspicious activity, and investigating potentially suspicious activity. Although certain individual reports were filtered to identify items for further review, the Firm did not centralize or integrate the information generated by the various reports used by the AML Officer. Moreover, during the relevant time period, more than 2,100 client accounts — approximately 3.3 accounts per business day — were identified as warranting further detailed investigation by the firm's AML Officer. The resources that RJFS devoted to AML compliance were inadequate in light of these extensive responsibilities.

RJFS Failed to Adequately Investigate Suspicious Activity in JR's Accounts

In addition to executing a large volume of options transactions, JR moved large sums of money in and out of his RJFS accounts, in large part to accomplish his Ponzi scheme. For example, in one ten-and-a-half-month period, JR deposited approximately $3.8 million in cash equivalents into one of his brokerage accounts and then wrote 1302 checks, mostly in round-dollar amounts, withdrawing funds from the account. Many of the checks were payments to "investors" of JR who were unknowingly participating in his Ponzi scheme.

During the relevant period, JR's accounts frequently triggered several RJFS exception reports. JR's accounts appeared on the Firm's Structured Deposit Report almost every week. The Structured Deposit Report sorted cash equivalent deposits over the preceding 90- and 365-day periods in order to detect potential structuring. JR's voluminous check writing also repeatedly appeared on the Excessive Activity Report generated by RJFS's affiliate, who shared this information with RJFS. Finally, on several occasions JR's account appeared on RJFS's Third Party Disbursements Report after JR wired funds to pay off relatives of "investors" who had died or who had sued him.

By the beginning of 2005, the AML Officer had identified potential money laundering concerns associated with the flow of funds in and out of JR's account, and with JR's unusual practice of writing checks in round dollar amounts. On January 5, 2005, RJFS's AML Officer emailed the registered representative assigned to JR's accounts, asking the

registered representative to explain the unusual account activity. The AML Officer specifically referred to the large number of deposits in the brokerage account and the large number of checks JR then wrote from his money-market account, generally in round-dollar amounts:

> "One of the reports I review for suspicious activity monitors for the use of cash equivalents (e.g. money orders, cashier's checks, etc.) [One of JR's accounts] has a history of using cash equivalent deposits... [f]or the most part, all of your client's cash equivalents are for over $10k. However, your client does make a very large number of these type of deposits (compared to other accounts). Case in point, in the last 90 days a total of 12 cash equivalent deposits totaling ~ $373k have been made into this account. This concern is then multiplied by the fact that your client also writes numerous checks out of their [money market] sweep account. These checks are generally in pretty standard amounts (e.g. $1500.00 as opposed to say $1497.23 as if they were buying something). What this results in is a very large amount of money is flowing through the account in a suspicious manner coming in as cash deposits and leaving via [money market] checks. I do see there is some extensive investing in this account, but as I said there is still a very large flow of funds through this account.
>
> The PATRIOT Act requires that we monitor for suspicious activity in accounts. One practice that raises suspicion is the use of cash equivalents, and/or the flow of funds into and back out of an account. Therefore, would you please provide me with an explanation as to why your client makes transactions in this manner."

In response, the registered representative provided the following explanation for the account activity:

> "I have known [JR] for over 25 years . . . . [JR] is a very successful businessman. He not only has a portfolio of stock and options, but also Real estate, cars, and a very successful insurance firm. The deposits that come into his account are the proceeds from the periodic sales of these numerous assets. The income that he makes from the call options is used to fund his ventures into real estate, cars, and the expenses that go along with those transactions. [JR] is a meticulous bookkeeper and likes to have a paper trail for all transactions. Therefore he prefers Bank Checks to conduct transactions because of the reasons listed previously.... I can vouch for [JR's] honesty and integrity. I feel that Raymond James has nothing to be concerned with. If you have any additional questions, please let me know. "

Over the next two and a half years, RJFS's AML Officer continued to email the registered representative about the round-dollar check writing and flow of funds in and out of the account. Specifically, in October 2005 and again in August 2006, the AML Officer emailed the registered representative about the numbers of deposits and checks in JR's account, and sought further details of the activity, noting that JR "makes numerous

deposits via cash equivalents totaling hundreds of thousands of dollars each month." For example, on October 4, 2005, the AML Officer wrote:

> "[T]his account appears on one of my reports I review quite frequently...As you presumably know, [JR] makes numerous deposits via cash equivalents totaling hundreds of thousands of dollars each month. Per your email below you explained that these were proceeds from the periodic sale of his assets, but from the level of deposits this would mean he sells quite a large number of (large ticket) items??? .... And I am curious to know what all the [money market] checks are for?? He routinely writes numerous checks, almost always for even dollar amounts."

On August 22, 2006, the AML Officer again contacted the registered representative assigned to JR's account with the same concerns:

> "[Since October 2005] there has been approx $3.8 million dollars of cash equivalents (official checks, cashiers checks, etc) deposited into the account and 1302 [money market] checks written totaling ~$3.9+ million. A flow of funds into and back out of an account can be a sign of money laundering. While I am certainly not implying anything of this sort has taken place I do have the responsibility to question the activity and document your reply. Could you please take a moment and provide me with the circumstances surrounding this activity and any additional detail(s) you think I should be aware of."

In response to each of these emails, the registered representative assigned to the account provided the same explanation for the account activity—that the large flow of funds in and out of the account resulted from JR's dealings in real estate and cars. This information had been obtained several years earlier when JR opened his first account with RJFS. In spite of the unusual nature of the response, no one at RJFS attempted to pursue the concerns about JR's account activity directly, contact the branch manager, or ascertain whether JR had been asked about the account activity. Nor did anyone at RJFS conduct an adequate review of the checks JR had written, even though they were presented to the RJFS AML officer for review. Instead, RJFS relied on the information provided by the registered representative and a Lexis report that listed JR's properties and vehicle registrations. The registered representative never adequately explained, and RJFS never determined, why JR frequently wrote checks in round dollar amounts.

RJFS Failed to Implement its AML Program to Adequately Consider Numerous Red Flags Related to JR's Accounts

During the relevant time period, different departments at RJFS failed to share information about potential red flags concerning suspicious activity in JR's accounts with each other and with the firm's AML Officer. For instance, RJFS's Legal Department failed to inform the AML Officer about a criminal inquiry and allegations that JR had converted funds and deposited them into his RJFS account. Similarly, the local branch office where

JR's accounts were located failed to report red flags related to JR's account activity and legal troubles to the AML officer. The firm's AML Officer also failed to adequately review information they were provided.

Even with respect to information that was provided to the firm's AML Officer, RJFS failed to adequately implement its procedures to review that information. For example, checks written by JR from his money market account showed that he was writing round dollar checks in identical amounts to the same individuals each month. Although the checks were specifically provided to RJFS's AML Officer for review, an adequate review of those checks was never conducted.

As a result of these failings, RJFS did not adequately consider certain red flags related to activity in JR's accounts that were indicative of suspicious activity. These red flags included the following:

1. A civil complaint was served on RJFS by a relative of JR alleging that JR had converted funds, deposited them into his RJFS accounts, and improperly acted as an investment advisor. Although RJFS was aware of the lawsuit and had reviewed the complaint, no one at RJFS provided the AML Officer with a copy of the complaint. Likewise, no one at RJFS informed the AML Officer that JR had "invested" a relative's money in his RJFS account.

2. RJFS's AML Officer was provided with a subpoena issued to RJFS by the Ohio Division of Securities that sought information about JR's accounts. However, because RJFS failed to adequately review that subpoena, RJFS AML personnel took no further action with respect to the subpoena.

3. JR had questioned the branch manager at the office where his account was located about the possibility of investing on behalf of others using his RJFS accounts. No one at the branch informed the firm's AML Officer of these facts.

4. In early June of 2007, the registered representative assigned to JR's accounts received a Grand Jury Subpoena to testify and provide documents about JR. Although a copy of the subpoena was provided to RJFS on June 5, 2007, no one informed the AML Officer of the subpoena, even though RJFS's procedures required its AML Officer to review and conduct a risk assessment of any customer who was the subject of a subpoena.

5. Several weeks before the Ohio Division of Securities initiated the complaint to seize JR's assets, JR told personnel at the branch office where his account was located that he had been investing on behalf of "family members" using his RJFS accounts. No one at the branch informed the firm's AML Officer of these facts.

6. Shortly before the Ohio Division of Securities initiated the complaint to seize JR's assets, JR told local branch personnel that he had committed fraud and was going to jail. No one at the RJFS branch provided this information to the firm's AML Officer.

Because RJFS did not adequately identify or consider numerous red flags related to JR's accounts, it also failed to adequately consider whether it should file a Suspicious Activity Report with respect to the accounts, as required by the Bank Secrecy Act and the implementing regulations promulgated thereunder.

RJFS Failed to Conduct Adequate Monitoring of JR's Accounts

In part because of the inadequate investigation described above, RJFS also failed to conduct adequate monitoring of JR's accounts. The firm's AML Officer recognized that JR wrote checks in "round dollar amounts," frequently to the same individuals, and identified the flow of funds into and out of the accounts as a potential problem. In spite of this, RJFS did not adequately follow up on these concerns. For instance, RJFS did not follow up when the registered representative failed to provide an explanation for the fact that the checks were written in round dollar amounts. RJFS also failed to review JR's physical account file, which would have demonstrated JR's pattern of depositing third party stock certificates. The firm's Stock Receive Department, which it had outsourced to its affiliate, also failed to monitor JR's repeated deposits of third party stock certificates.[1] Finally, RJFS failed to contact the Branch Manager about JR's account activity—even though the firm's AML Procedures specifically tasked the AML Officer with communicating with Branch Managers.

As described above, RJFS also devoted inadequate resources to its AML program in light of the limitations of its review processes. In addition, RJFS's AML Officer was unable to review, as a practical matter, the various instances that JR's accounts had triggered the firm's exception reports. The firm's processes did not realistically allow the AML Officer to call up each of the past instances in which JR's accounts had triggered those reports.

Because RJFS did not conduct adequate monitoring of JR's accounts, it also failed to adequately consider whether it should file a Suspicious Activity Report with respect to the activity in the accounts, as required by the Bank Secrecy Act and the implementing regulations promulgated by the Department of the Treasury.

Violations

RJFS Violated NASD Rules 3011(and 2110)[2]

NASD Conduct Rule 3011(a) requires that member firms must, at a minimum, "establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of suspicious transactions required under 31 U.S.C. 5318(g) and the

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[1] JR repeatedly deposited third party stock certificates into his accounts and sometimes accepted physical stock certificates from the investors in his Ponzi scheme.

[2] Effective January 1, 2010, NASD Rule 3011 became FINRA Rule 3310.

implementing regulations thereunder." In developing its AML program, a broker-dealer should consider factors such as its size, location, business activities, the types of accounts it maintains, and the types of transactions in which its customers engage.[1] Two FINRA Notices to Members, 02-21 and 02-47, emphasize a member's duty to detect "red flags" and, if detected, to "perform additional due diligence before proceeding with the transaction."

As described above, RJFS failed to implement policies and procedures that could reasonably have been expected to detect and cause the reporting of suspicious activity in the accounts of JR, who was operating a Ponzi scheme. Numerous red flags were either not provided for review, or not adequately considered, by the firm. Even after the firm became aware of a highly unusual flow of funds in and out of the accounts, it failed to conduct adequate due diligence or monitoring of the activity in JR's accounts, in part because the firm devoted inadequate resources to its AML department.

By failing to implement policies and procedures that were reasonably designed to detect and cause the reporting of suspicious transactions in the accounts of JR, RJFS violated NASD Rules 3011(a) and 2110.

B. RJFS also consents to the imposition of the following sanctions:

1. A censure;

2. A fine in the amount of $400,000; and,

3. The undertaking described below.

Undertaking: RJFS shall conduct a comprehensive review of the adequacy of its AML policies, systems, procedures (written and otherwise), and training. At the conclusion of the review, which shall be no more than 90 days after the date of the Notice of Acceptance of this AWC, RJFS shall certify that its procedures are reasonably designed to achieve compliance with FINRA Rule 3310 (formerly NASD Rule 3011). The certification shall be provided in a written letter to FINRA staff, and signed by a corporate officer of RJFS on behalf of RJFS. The letter should identify the Respondent and the case number, and shall be submitted by e-mail to EnforcementNotice@FINRA.org and by letter to Thomas Kimbrell, Senior Counsel, FINRA, Department of Enforcement, 1801 K Street NW, Suite 800, Washington DC 20006. In addition, at the time the certification is provided, RJFS will provide the staff with a copy of its procedures relating to compliance with FINRA Rule 3310.

RJFS agrees to pay the monetary sanction(s) upon notice that this AWC has been

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[1] *See* Notice to Members 02-21 at 4.

accepted and that such payment(s) are due and payable. RJFS has submitted an Election of Payment form showing the method by which the firm proposes to pay the fine imposed.

RJFS specifically and voluntarily waives any right to claim that the firm is unable to pay, now or at any time hereafter, the monetary sanction(s) imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

RJFS specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

A. To have a Complaint issued specifying the allegations against it;

B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;

C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and,

D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, RJFS specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

RJFS further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

RJFS understands that:

A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;

B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against RJFS; and

C. If accepted:

1. this AWC will become part of RJFS's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against RJFS;

2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about my disciplinary record;

3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and

4. RJFS may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. RJFS may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects RJFS's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

D. RJFS may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. RJFS understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf

has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that RJFS has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce RJFS to submit it.

2/28/2012
Date ~~(mm/dd/yyyy)~~

Respondent

Raymond James Financial Services, Inc.

By: [signature]
PRESIDENT

Reviewed by:

[signature]
Neal E. Sullivan
Gerald J. Russello
Paul M. Tyrrell
Counsel for Respondent
Bingham McCutchen LLP
2020 K Street NW
Washington, DC 20006-1806
202-373-6159

Accepted by FINRA:

3/29/12
Date

Signed on behalf of the
Director of ODA, by delegated authority

[signature]
Thomas B. Lawson
~~Vice President and~~ Chief Counsel
FINRA Department of Enforcement
1801 K Street NW, Suite 800
Washington, DC 20006

FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2014041196601

TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

RE: Morgan Stanley Smith Barney LLC, Respondent
CRD No. 149777

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent Morgan Stanley Smith Barney LLC ("Morgan Stanley," the "Firm," or "Respondent") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Respondent alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

A. Morgan Stanley hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

Morgan Stanley has been a FINRA member firm since May 2009. The Firm was created through the merger of the Global Wealth Management Group of Morgan Stanley & Co. LLC (CRD No. 8209) and the Smith Barney Division of Citigroup Global Markets Inc. (CRD No. 7059) into a joint venture. Morgan Stanley is headquartered in Purchase, New York. As of October 2018, the Firm had over 23,900 registered persons and approximately 758 branch offices.

RELEVANT DISCIPLINARY HISTORY

Morgan Stanley has no formal relevant disciplinary history with the Securities and Exchange Commission, any state securities regulator, or any self-regulatory organization.

OVERVIEW

Beginning in 2011, Morgan Stanley failed to develop and implement an anti-money laundering ("AML") program that was reasonably designed to achieve and monitor the Firm's compliance with the requirements of the Bank Secrecy Act ("BSA") and its

implementing regulations. Specifically, the Firm failed to establish and implement policies and procedures that were reasonably expected to detect and cause the reporting of potentially suspicious activity in the following three respects:

- First, from January 2011 until at least April 2016, several of the systems that the Firm used to send and receive wire transfer information suffered from significant flaws. Specifically, those systems failed to transmit certain wire information to the Firm's automated AML surveillance system ("Transaction Monitoring System" or "TMS"), undermining that system's surveillance of tens of billions of dollars of wire and foreign currency transfers, including transfers to and from countries known for having high money laundering risk.

- Second, from January 2011 to December 2013, the Firm failed to devote sufficient resources to review alerts generated by the Firm's automated AML system, and as a result, the Firm's AML analysts often closed alerts without sufficiently conducting and/or documenting their investigations of the potentially suspicious wire transfers that generated the alerts.

- Third, from January 2011 to December 2013, the Firm's AML Department failed to reasonably monitor customers' deposits and trades of low-priced securities ("penny stock") for potential AML issues, including insider trading and market manipulations, despite the fact that the Firm's customers deposited approximately 2.7 billion shares of penny stock, which resulted in subsequent sales totaling approximately $164 million, in that time period.

By virtue of the foregoing, Morgan Stanley violated FINRA Rules 3310(a) and 2010.

In addition, from January 2011 to December 2013, Morgan Stanley failed to establish and maintain a supervisory system reasonably designed to achieve compliance with Section 5 of the Securities Act of 1933 ("Section 5") and applicable rules and regulations. Specifically, the Firm divided responsibility for vetting its customers' deposits and sales of penny stock among its branch management and its Compliance and Executive Financial Services ("EFS") departments without reasonable coordination among them. Instead, the Firm primarily relied on its customers' representations that the penny stock they sought to deposit was not restricted from sale, and the representations of issuers' counsel that the customers' sales complied with an exemption from the registration requirements. As a result, the Firm failed to reasonably evaluate the customers' penny stock transactions for red flags indicative of potential Section 5 violations. Based on the foregoing, Morgan Stanley violated NASD Rule 3010(a) and FINRA Rule 2010.

Finally, in 2012 and 2013, Morgan Stanley had in place but failed to implement its policies, procedures, and internal controls reasonably designed to achieve compliance with the BSA and its implementing regulations by failing to conduct risk-based reviews of the correspondent accounts of certain foreign financial institutions ("FFIs"), as required by the BSA and its implementing regulations and the Firm's policies and procedures. As a result, Morgan Stanley violated FINRA Rules 3310(b) and 2010.

FACTS AND VIOLATIVE CONDUCT

I. Origin of the Matter

This matter arose out of firm examinations and cause examinations referred to FINRA's Department of Enforcement by FINRA's Department of Member Supervision, including its AML Investigations Unit.

II. The Firm's Failures Related to its AML Program

FINRA Rule 3310 requires member firms to "develop and implement a written anti-money laundering program reasonably designed to achieve and monitor ... compliance with the requirements of the Bank Secrecy Act (31 U.S.C. 5311, *et seq.*), and the implementing regulations promulgated thereunder by the Department of the Treasury." Among other AML program requirements is the mandate set forth in FINRA Rule 3310(a) that firms "[e]stablish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under 31 U.S.C. 5318(g) and the implementing regulations thereunder."

In April 2002, FINRA issued Notice to Members ("NTM") 02-21, which reminded broker-dealers of these obligations, and further advised broker-dealers that their AML procedures must address a number of areas, including monitoring "trading and the flow of money into and out of ... account[s]." NTM 02-21 also advised broker-dealers "to look for signs of suspicious activity that suggest money laundering" – or, "red flags" – and if they detect "red flags," to "perform additional due diligence before proceeding with the transaction." In August 2002, FINRA issued NTM 02-47, which set forth the suspicious activity reporting rule promulgated by the Department of the Treasury for the securities industry. NTM 02-47 further advised broker-dealers of their duty to file a suspicious activity report ("SAR") for any transactions raising suspicions of illegal activity occurring after December 30, 2002.

As described below, Morgan Stanley failed to establish and implement AML policies and procedures that were reasonably expected to detect and cause the reporting of suspicious transactions.

A. The Firm Failed to Conduct Reasonable Surveillance of Wire and Foreign Currency Transfers

Morgan Stanley uses a number of automated systems to process and to monitor wire and foreign currency transfers sent to and received by its customers. However, from January 2011 until at least April 2016, some of the systems for processing wires were impacted by significant design limitations and programing flaws, which affected the transmission of certain transaction-related information to the Firm's automated Transaction Monitoring System. As a consequence, Morgan Stanley failed to surveil hundreds of thousands of wire and foreign currency transfers – which transmitted tens of billions of

dollars – including money transfers to and from jurisdictions that the Firm deemed to have high money laundering risk.

TMS was a key part of Morgan Stanley's AML program during the relevant period. TMS was a proprietary system designed to conduct AML surveillance after the Firm transmitted customers' outgoing wires or credited incoming wires to customers' accounts. TMS monitored for potentially suspicious wires by comparing them to Firm-designed parameters, known as "scenarios," which identified patterns of transactions indicative of suspicious activity. In order for TMS to work properly, it needed to receive data from various other Firm systems. During the relevant period, however, multiple Morgan Stanley systems failed to provide certain data to TMS for monitoring as intended. As a result, TMS did not review that data for outgoing and incoming wires and foreign currency transfers for indications of suspicious activity.

For example, the Firm used two programs, called Global Currency and FX Ion, to facilitate its customers' transmission and receipt of foreign currencies. Morgan Stanley operated Global Currency, and contracted with a vendor to operate FX Ion. For more than five years, both Global Currency and FX Ion failed to transmit key data to TMS. As a result, Morgan Stanley failed to surveil through TMS at least 140,000 wires that it sent or received via these programs. The wires transmitted nearly $43 billion, including approximately $3.2 billion sent to or received from high-risk jurisdictions.

As another example, in December 2014, the Firm instituted a program that automated the settlement of certain incoming wires, but failed to assure that the program sent that wire data to TMS. Consequently, from December 2014 through April 2016, the Firm failed to surveil through TMS approximately 267,000 incoming wires that transmitted approximately $30.4 billion (which equaled approximately 65% of the incoming wires to its Morgan Stanley Wealth Management customers during that period). More than 16,000 of those wires, transmitting more than $1.8 billion, came from countries that the Firm had designated as high-risk jurisdictions.

Similarly, a Firm system for processing outgoing wires, known as the Outgoing Wire Transfer System ("OWTR"), also failed to send certain wire data to TMS as intended. As a result, from January 2014 to August 2015, Morgan Stanley sent out more than $25.5 billion (including $1.2 billion to high-risk jurisdictions) through approximately 91,000 outgoing wires that were not surveilled through TMS for the jurisdiction of the recipient account.

The Firm discovered some of the above-described system deficiencies while responding to FINRA staff's inquiries, and discovered others independently and brought them to FINRA staff's attention. In some instances, Morgan Stanley knew, or should have known, that certain wire and foreign currency transfer activity was not being monitored by TMS as intended, but failed to take timely remedial action. For example, the Firm knew in 2012 that an issue with OWTR caused correspondent banks to reject some outgoing wires to foreign banks, but the Firm did not consider whether the issue affected

TMS until late 2014, when the Firm began a review to respond to FINRA staff's inquiries.

Perhaps most significantly, starting in 2013, the Firm retained a consultant to test the integrity of the data that its systems sent to TMS. In or around August 2015, the consultant identified multiple "high-risk" issues to the Firm, that is, issues that could negatively impact the effectiveness of TMS. One such issue was that foreign currency transactions on the FX Ion platform did not transmit data to TMS, resulting in the Firm's complete failure to surveil transactions from that platform through TMS. In late 2016, the consultant was again utilized, this time to assist with testing potential data transmission issues identified by the Firm. The consultant identified additional data transmission problems that undermined TMS' surveillance of transactions that occurred via Global Currency and FX Ion. This issue was not remediated until at least February 2017.

B. The Firm Failed to Reasonably Investigate Potentially Suspicious Wire Transfers

When TMS identified potentially suspicious asset movements, including wire transfers to or from high-risk jurisdictions, it generated alerts that were sent to the Firm's AML analysts. Analysts were supposed to then review the wires that triggered the alerts to determine whether they involved potentially suspicious activity that warranted further investigation, and were supposed to document their reviews, for the purpose of determining whether the Firm should file SARs with the Financial Crimes Enforcement Network ("FinCEN"), a bureau of the Treasury Department.

However, from January 2011 to December 2013, the Firm's AML analysts sometimes failed to conduct reasonable due diligence and/or document their reviews of TMS alerts in a manner reasonably expected to detect and cause the reporting of suspicious transactions. Analysts' written comments about the alerts at times failed to explain the investigative steps they took to reach their conclusion to close the alerts. The comments also sometimes failed to address whether the transaction at issue had a business or other legal purpose that would explain why further investigation was unwarranted.

The Firm's AML analysts had extraordinary workloads that likely contributed to their unreasonable reviews. From January 2011 to December 2013, the Firm employed, at most, only 24 AML analysts (including consultants), who were tasked each day with reviewing the Firm's significant volume of TMS alerts, in addition to performing other AML-related duties.

C. The Firm Failed to Reasonably Monitor Trading in Penny Stock for AML Issues

From January 2011 to December 2013, Morgan Stanley customers deposited approximately 2.7 billion shares of penny stock,[1] which resulted in subsequent sales totaling approximately $164 million. During that time period, the Firm did not establish and implement policies and procedures reasonably expected to detect and cause the reporting of suspicious transactions in penny stock.

First, the Firm's written procedures were not reasonable. They required registered representatives and branch management to identify red flags surrounding penny stock deposits and liquidations, but did not instruct them to notify the Firm's AML Department if they found any such red flags. Meanwhile, the Firm's AML Department procedures did not address the Department's review of customers' deposits and liquidations of penny stock.

With respect to the Firm's systems, the Firm's AML Department did not use automated surveillance tools to monitor for potentially suspicious trading in penny stock. Instead, the Firm relied, in part, on its branch management to conduct manual reviews of daily trade blotters.[2] The Firm's Compliance Department reviewed a report that monitored deposits of large blocks of penny stock; although the Compliance Department referred potentially suspicious securities transactions to the Firm's AML Department for further review, it made only 114 such referrals from January 2011 to December 2013, and several of those arose from regulatory requests and news stories. During the relevant period, the Firm also relied on its Compliance Department to monitor for potential insider trading, but that Department only reviewed the *Wall Street Journal* "Market Movers" list of stocks with a 10% change in their end of day price. The reviewer then manually reviewed trading in those securities by Firm clients. The Compliance Department therefore did not generally consider intra-day price swings or review trading in penny stock, which typically are not exchange-listed.

As a result of the Firm's unreasonable policies and procedures, from January 2011 to December 2013, Firm customers deposited and sold penny stock under circumstances that should have raised red flags that the securities may not have been registered under securities laws or otherwise exempt from registration, or that the trades were potentially manipulative. As one example, a Morgan Stanley customer that purported to be a "holding company" of corporate stock made five deposits of stock certificates totaling more than 45 million shares of a marijuana-industry penny stock issuer in a two-month

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[1] "Penny stock" are equity securities issued by a small company, priced under $5 per share and typically traded over-the-counter. *See* Securities and Exchange Commission Penny Stock Rules, available at http://www.sec.gov/answers/penny.htm. Morgan Stanley used a similar definition of penny stock in its compliance procedures.

[2] Although the applicable procedures instructed branch management to review the trade blotter for certain types of trades that might require further investigation generally, including purchases of penny stock, the procedures did not specifically instruct branch management to review those trades for suspicious activity or identify any indicia of suspicious activity.

period. The customer began selling the stock one day after its first deposit, and sold all of its stock within three months, for proceeds of nearly $3 million. While it held stock at the Firm, the customer posted on a blog that it had aided the issuer in "going public" and announced, falsely, its intent to keep the stock as a long-term investment. Press releases, web sites, and subscription services also touted the issuer, and the stock's price and trading volume significantly increased. The customer did not meet the Firm's standards for the deposit of penny stock, but the Firm, as allowed for in its procedures, granted an exception to the customer upon a request by the branch office that managed the customer's account. The Firm did not have independent information that the customer's stock was registered or that the sales were exempt from registration requirements; rather, the Firm seemingly relied on the customer's own representations and opinion letters from the issuer's counsel.

By failing to establish and implement policies and procedures that were reasonably expected to detect and cause the reporting of suspicious transactions, Morgan Stanley violated FINRA Rules 3310(a) and 2010.

III. The Firm's Supervisory Failures Related to Section 5

NASD Rule 3010(a) required firms to "establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules."

Section 5, in relevant part, prohibits the sale of any security unless a registration statement is in effect or there is an applicable exemption from the registration requirements. In January 2009, FINRA issued Regulatory Notice ("RN") 09-05, which identified certain red flags that should alert member firms to the possibility that a customer is participating in an illegal distribution of a security in violation of Section 5. As set forth in RN 09-05, "problems can arise when firms fail to recognize or take appropriate steps when confronted with 'red flags' that signal the possibility of an illegal, unregistered distribution." RN 09-05 also reminded firms that "FINRA, the SEC and the courts have repeatedly held that firms cannot rely on outside counsel, clearing firms, transfer agents, issuers, or issuer's counsel to discharge their obligations to undertake an inquiry" about their customers and the source of their securities. Moreover, RN 09-05 instructed firms that the fact that securities were issued by a transfer agent without a restrictive legend does not mean that those securities can be resold immediately and without limitation.

From January 2011 to December 2013, the Firm failed to establish and maintain a supervisory system reasonably designed to achieve compliance with Section 5. The Firm divided responsibility with respect to deposits and sales of penny stock among three groups: (1) branch management; (2) the Compliance Department, whose approval was required to deposit penny stock; and (3) EFS, the department at the Firm whose approval was required to sell restricted and control securities, including penny stock. None of these groups, alone or together, conducted a searching inquiry to determine whether

penny stock deposited at the Firm was eligible for immediate resale to the public. Instead, the Firm unduly relied on customers' self-certifications and issuers' counsel's representations that the stock was freely tradeable. Additionally, the three groups failed to consistently communicate with each other – even when one determined that a customer might own restricted securities.

For example, during the relevant period, branch management required customers to complete a form, known as the Shareholder Representation Letter ("SRL"), which asked customers to state whether their stock was restricted, but generally the branch management did not obtain any documents to evaluate the accuracy of the customers' representations. The Firm's written procedures required branch management to provide the SRL to the Compliance Department for its review, but branch management sometimes failed to do so. In other instances, the Compliance Department permitted customers to deposit potentially restricted or control penny stock on the condition that branch management contacted EFS regarding any future sales of that stock, but the Compliance Department at times did not notify EFS about those conditional approvals or identify in Firm systems that EFS approval was required for any resale. Consequently, branches at times did not follow the Compliance directive to contact EFS regarding the sale of restricted or control penny stock.

During the relevant period, the Firm had insufficient controls within the branches to prevent or detect customer transactions in potentially restricted or control penny stock from being processed without review and approval by EFS. For example, branches could circumvent EFS' review prior to the sale of any such stock by simply choosing not to enter transaction information in a Morgan Stanley system used to alert EFS about customers' intentions to sell potentially restricted or control penny stock. By choosing not to enter transaction information, branches could avoid EFS review, as well as a $300 fee that EFS charged for its review of certain physical securities. In any event, EFS' review of customers' sales of restricted or control penny stock was unreasonable. Like branch management and the Compliance Department, EFS unduly relied on customers' representations, as well as the representations of issuers' counsel, that restricted or control penny stock was registered or exempt from registration. Additionally, at least some branch managers and EFS employees erroneously believed that restricted penny stock in certificate form would always bear a legend indicating its restricted status.

Based on the foregoing conduct, Morgan Stanley violated NASD Rule 3010(a) and FINRA Rule 2010.

IV. The Firm's Failure to Conduct Periodic Reviews of the Correspondent Accounts of Certain FFIs

FINRA Rule 3310(b) requires a member firm to establish and implement policies, procedures, and internal controls reasonably designed to achieve compliance with the BSA and its implementing regulations, including 31 C.F.R. § 1010.610. Firms are required pursuant to 31 C.F.R. §1010.610(a) to establish a due diligence program that includes specific, risk-based policies, procedures, and controls that are reasonably

designed to detect and report any known or suspected money laundering activity conducted through or involving any correspondent account for an FFI. Such policies, procedures, and controls are required to include "a periodic review of the correspondent account activity sufficient to determine consistency with information obtained about the type, purpose, and anticipated activity of the account."

In 2012 and 2013, Morgan Stanley failed to conduct such reviews of account activity in the correspondent accounts of certain FFIs, as required by the BSA and its implementing regulations as well as the Firm's policies and procedures. The Firm's policies and procedures required it to conduct annual reviews of correspondent accounts of "high risk FFI" customers, which the Firm defined as those organized or located in "high risk" jurisdictions. Morgan Stanley, however, did not conduct annual reviews of any high-risk FFI accounts (and some other FFI accounts) in 2012 or 2013. The Firm began those reviews in December 2014, after FINRA staff asked about the Firm's reviews.

Based on the foregoing, Morgan Stanley violated FINRA Rules 3310(b) and 2010.

OTHER FACTORS

Morgan Stanley has taken extraordinary steps and devoted substantial resources since 2013 to expand and enhance its AML policies and procedures, automated transaction monitoring system, and other AML-related programs. As part of this effort, the Firm invested substantial additional financial resources in those programs, and greatly increased its AML-related staffing. Among other steps taken to improve its programs, the Firm retained a third-party vendor, trained and vetted by the Firm, to conduct the initial reviews of all TMS-generated alerts. Additionally, the Firm developed and implemented new automated scenarios to surveil penny stock transactions and potential insider trading, and revised its policies, procedures, and controls related to pre-deposit and pre-sale reviews of penny stock. The Firm also self-reported relevant issues to the attention of FINRA staff.

Accordingly, the sanctions imposed by this AWC reflect FINRA's consideration of these extraordinary corrective actions already taken by Morgan Stanley.

B. Morgan Stanley also consents to the imposition of the following sanctions:

1. A censure; and

2. A fine of $10 million.

Respondent agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. Respondent has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

Respondent specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

Respondent specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

A. To have a Complaint issued specifying the allegations against it;

B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;

C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and

D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

Respondent understands that:

A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule

9216;

B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent;

C. If accepted:

1. This AWC will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against it;

2. This AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;

3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and

4. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Respondent may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Respondent's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

D. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

The undersigned, on behalf of Respondent, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that Respondent has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce Respondent to submit it.

Morgan Stanley Smith Barney LLC

12/12/18
Date (mm/dd/yyyy)

By: D. Scott Tucker
Managing Director

Reviewed by:

12/13/18

David Meister, Esq.
Skadden, Arps, Slate, Meagher & Flom LLP
4 Times Square
New York, NY 10036
Phone: 212-735-2100
Email: david.meister@skadden.com

Accepted by FINRA:

12/26/18
Date

Signed on behalf of the
Director of ODA, by delegated authority

Stuart P. Feldman
~~Senior Counsel~~
FINRA Department of Enforcement
99 High Street, Suite 900
Boston, MA 02110
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FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2017053708001

TO: Department of Enforcement
Financial Industry Regulatory Authority (FINRA)

RE: Hilltop Securities, Inc.
CRD No. 6220

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent Hilltop Securities, Inc. ("Hilltop," "Respondent," or "the Firm") submits this Letter of Acceptance, Waiver and Consent (AWC) for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Respondent alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

A. Respondent hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

Hilltop has been a FINRA and MSRB member since May 1972. Hilltop conducts a full-service retail brokerage business and provides securities clearing services to over 150 introducing/correspondent firms. Hilltop, headquartered in Dallas, Texas, currently has approximately 492 registered individuals and 69 branch offices.

Hilltop Holdings, Inc. completed its acquisition of SWS Group, Inc. on January 1, 2015. SWS's broker-dealer subsidiaries, including Southwest Securities, Inc., became subsidiaries of Hilltop Securities Holdings, LLC, a holding company directly under Hilltop Holdings, Inc. and the successor of SWS Group, Inc. in the merger. In connection with the merger, First Southwest Company, LLC, a separate broker dealer, and its related entities also became subsidiaries of Hilltop Securities Holdings LLC. First Southwest Company, LLC and Southwest Securities, Inc. subsequently merged into what is now Hilltop Securities, Inc., which was completed on January 25, 2016.

RELEVANT DISCIPLINARY HISTORY

Hilltop has no relevant disciplinary history.

OVERVIEW

Between February 1, 2015 and April 30, 2016 (the "AML Relevant Period"), Hilltop failed to establish and implement an AML compliance program reasonably designed to detect and report suspicious trading activity in low-priced securities. During the AML Relevant Period, customers introduced to Hilltop traded at least 2.07 billion shares of low-priced securities, valued at approximately $221 million. These 2.07 billion shares were not subject to a reasonable review to detect and investigate red flags of suspicious activity for purposes of determining whether to file a suspicious activity report ("SAR"). Specifically:

- The Firm failed to follow the Department of Treasury's standard for determining whether to file a SAR – requiring proof of actual fraud as opposed to suspicion that a transaction involved unlawful activity or lacked an apparent lawful purpose;[1]

- Hilltop failed to implement its AML procedures requiring the collection and completion of Deposit Review Forms in connection with the deposit of low-priced securities, resulting in missed red flags of potentially suspicious activity; and

- Hilltop's AML compliance program failed to reasonably detect and report suspicious trading activity, in part, because Hilltop failed to devote adequate resources to its AML program. Hilltop's two to three AML analysts were tasked with reviewing a report that did not provide for a reasonable AML review. Due to deficiencies in the report, the analysts did not use risk-based factors to choose transactions for review and, based on sample reviewed by the Staff, were only able to review approximately 20% of the transactions; these 20% were not the highest risk transactions at the Firm.

As a result of this conduct, Hilltop violated FINRA Rules 3310(a) and 2010.

Additionally, from July 2011 to March 2016 (the "MSRB Relevant Period"), Hilltop failed to submit Form G-32 information to the Electronic Municipal Market Access System ("EMMA") in connection with 122 primary offerings of municipal securities. The Firm also made four Form G-32 filings to EMMA that were between 1 and 3 days late. Such conduct violated MSRB Rule G-32. Furthermore, between January 2012 and September 2015, Hilltop failed to provide required MSRB Rule G-17 disclosure letters to issuers in connection with 119 of the 122 offerings plus one other offering, in violation of

[1] *See*, 31 C.F.R., § 103.19(a)(1), providing that, "[e]very broker or dealer in securities within the United States . . . shall file with FinCEN . . . a report of any suspicious transaction relevant to a possible violation of law or regulation."

MSRB Rule G-17. Finally, from October 2014 to September 2015, in connection with 45 of the 122 offerings, the Firm failed to report on Form G-37 that it had conducted municipal securities business. As a result of this conduct, Hilltop violated MSRB Rule G-37.

FACTS AND VIOLATIVE CONDUCT

AML Rule Violations

A. Hilltop's AML Program Was Not Reasonably Designed to Detect and Cause the Reporting of Potentially Suspicious Activity.

FINRA Rule 3310 requires FINRA regulated broker-dealers to "develop and implement a written anti-money laundering program reasonably designed to achieve and monitor [their] compliance with the requirements of the Bank Secrecy Act (31 U.S.C. 5311, *et seq*.) and the implementing regulations thereunder. . . ." Under FINRA Rule 3310(a), the program must, at a minimum, establish and implement policies and procedures that "can be reasonably expected to detect and cause the reporting of" transactions required to be reported under 31 U.S.C. § 5318(g) and the implementing regulations thereunder. A violation of FINRA Rule 3310(a) is also a violation of FINRA Rule 2010, which requires FINRA regulated broker-dealers to observe "high standards of commercial honor and just principles of trade."

Broker-dealers are also required to file "a report of any suspicious transaction relevant to a possible violation of law or regulation" pursuant to 31 C.F.R. §1023.320. The U.S. Treasury Department has instructed broker-dealers to determine whether trading activity raised suspicions by monitoring for various "red flags."[2] FINRA issued guidance to member firms that they have a duty to (a) tailor their AML program to the particular risks of its business model, as well as its customer base; (b) monitor red flags of suspicious activity; and (c) where suspicious activity is detected, perform additional due diligence to determine whether or not to file a SAR.[3]

As described below, during the AML Relevant Period, the Firm's AML program was not reasonably designed to detect and report potentially suspicious activity.

1. The Firm Failed to Follow the Treasury Dept.'s Standard for Determining Whether to File a SAR.

Title 31 U.S.C. § 53l8(g) authorizes the Department of the Treasury to issue suspicious activity reporting requirements for broker-dealers. The Department of the Treasury issued the implementing regulation, 31 C.F.R., § 103.19(a)(1), on July 1, 2002.[4] It provided that, with respect to any transaction after December 30, 2002, "[e]very broker or

[2] 67 Fed. Reg. 44048 (July 1, 2002) *(http://www.treas.gov/fincen/brokersdealersarjuly2002.pdf)*.
[3] NASD Notices to Members 02-21 and 02-47.
[4] On March 1, 2011, 31 C.F.R Part 103 was transferred to 31 C.F.R. Chapter X, resulting in a new citation of 31 C.F.R. § 1023.320(a) for this section. There were no substantive changes.

dealer in securities within the United States . . . shall file with FinCEN . . . a report of any suspicious transaction relevant to a possible violation of law or regulation." Section (a)(2) of that regulation specifically provides:

> A transaction requires reporting . . . if it is conducted or attempted by, at, or through a broker-dealer, it involves or aggregates funds or other assets of at least $5,000, and the broker-dealer knows, suspects, or has reason to suspect that the transaction (or a pattern of transactions of which the transaction is a part):
>
> (i) Involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity (including, without limitation, the ownership, nature, source, location, or control of such funds or assets) as part of a plan to violate or evade any federal law or regulation or to avoid any transaction reporting requirement under federal law or regulation;
>
> (ii) Is designed, whether through structuring or other means, to evade any requirements of this part or of any other regulations promulgated under the Bank Secrecy Act, . . . ;
>
> (iii) Has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the broker-dealer knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction; or
>
> (iv) Involves the use of the broker-dealer to facilitate criminal activity.

When the Firm reviewed low-priced securities transactions, the Firm applied an unreasonably high threshold for the filing of SARs. As a result, the Firm routinely failed to consider filing a SAR on suspicious activity concerning low-priced securities in multiple instances. Under 31 C.F.R. § 1023.320(a) (2), the Firm is required to file a SAR for any transaction that it knows, suspects, or has reason to suspect "has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage." Although the Firm's written supervisory procedures tracked language in 31 C.F.R. § 1023.320(a) regarding the threshold for SAR filing, in practice, the Firm would not file a SAR unless it had evidence proving that the low-priced security was part of a fraudulent scheme, even where activity triggered multiple red flags. The Firm's SAR filing threshold would not reasonably be expected to cause the reporting of suspicious transactions considering that 31 C.F.R § 1023.320 states broker-dealers are required to report "any suspicious transaction relevant to a ***possible*** violation of law or regulation." (Emphasis added).

2. Hilltop Failed to Review Red Flags due to its Failure to Implement its AML Procedures Regarding Receipt of Low-priced Securities.

The Firm's AML Procedures regarding Low-Priced Securities

The Firm's written AML procedures required its associated persons to collect and complete Deposit Review Forms for all receipt of low-priced securities positions. These forms required, among other things, information on whether the stock had undergone a reverse merger in the prior year; whether the stock had undergone a name or business change; the number of shares owned by the customer overall, including at other firms; revenue of the issuer; the exchange on which the stock was listed; and the total outstanding shares of the stock on the market.

A review of low-priced securities deposits revealed that Hilltop routinely failed to obtain the Deposit Review Forms required by its AML procedures. When Hilltop did obtain the Deposit Review Forms, many in the sample reviewed were inaccurate or incomplete, including forms with incorrect figures for total shares outstanding or public float, inaccurate representations regarding where the stocks were listed, inaccurate representations regarding recent reverse mergers or other reorganizations, and inaccurate representations about the customer having additional shares of an issuer for sale.

The Firm's Failure to Implement its Low-Priced Securities Procedures as to Customer 1

Hilltop's failure to implement its procedures requiring the completion of Deposit Review Forms resulted in the failure of the Firm to review for red flags in millions of shares deposited by Customer 1 during the AML Relevant Period. Even when it was aware of Customer 1's activity, the Firm failed to recognize the potentially suspicious nature of the activity, in part, because of the unreasonably high threshold for SAR filing applied by the Firm.

Customer 1 was introduced to Hilltop by FINRA member firm Introducing Firm A which cleared through Hilltop. In 2012, FINRA fined Introducing Firm A's CCO, Individual 1, $50,000 and suspended him in all capacities for three months because of his failures to monitor, detect, and investigate suspicious low-priced securities deposits and sales. Individual 1 signed the Deposit Review Forms for Introducing Firm A's customers, including Customer 1, which made it especially important for Hilltop to closely monitor these deposits. Customer 1's business involved loaning capital to small market companies via convertible debentures, which meant the loans were often repaid through transfer and liquidation of shares of low-priced securities, which presented risks of money laundering and unregistered distributions, among others.[5] During the AML

[5] This business model is sometimes referred to as toxic debt financing or death spiral financing. The SEC has previously warned that "Certain convertible securities, particularly those referred to as 'toxic' or 'death spiral' convertibles, present the temptation for persons holding the convertible securities to engage in manipulative short selling of the issuer's stock in order to receive more shares at the time of conversion." https://www.sec.gov/news/press/2003-26.htm.

Relevant Period, activity in the accounts of Customer 1 represented 25% of Hilltop's overall clearing of transactions in low-priced securities.

In 2015, the CEO of Customer 1 opened another account at Hilltop for the purpose of depositing shares of a low-priced company. In June 2015, the low-priced company underwent a 1:150 reverse stock split, which temporarily increased the price from $0.046 to $7.00 per share. Publicly available information also reflected that the low-priced company had recently changed its name, industry and business focus. As of June 2015, the low-priced company was still a development stage company, had generated no revenue, and had a deficit of $55 million. The name, industry and business change, lack of revenue, and the reverse stock split all presented heightened risk that the low-priced company could be involved in fraudulent activity.

Two accounts controlled by Customer 1 made 31 deposits of the low-priced company, totaling approximately 40 million shares during the AML Relevant Period. The deposits were followed by immediate liquidations and wiring out of funds. Also, none of the forms disclosed that the low-priced company had undergone a 1:150 reverse split, despite specific questions on the form and the fact that the information was publicly available in SEC Filings and on the OTC markets website. Reverse splits are a red flag listed in the Firm's procedures and should have been detected and prompted an inquiry regarding whether the Firm should file a SAR, particularly in light of the Customer 1's business of toxic debt financing and pattern of depositing stocks followed by immediate liquidation.

In the case of Customer 1, Hilltop failed to apply certain of its procedures to review of deposits by Customer 1. For example, the Deposit Review Forms represented that Customer 1 did not have additional shares for sale despite the Firm's knowledge of Customer 1's outstanding convertible debentures with the issuers and Customer 1's repeated pattern of converting, depositing, and immediately selling shares obtained via these convertible debentures. The Low-Priced Deposit Review Forms also inaccurately represented that Customer 1 did have not shares outside of the firm despite contrary indications in the documents produced. Importantly, these inaccurate/incomplete entries were relevant to red flags within the Firm's procedures.

The failure to implement its AML procedures meant that Hilltop accepted deposit of millions of shares of low-priced securities without having sufficient information to perform a review for red flags. Without this information, Hilltop could not make a reasonable determination regarding the suspicious nature of the transactions and whether a SAR filing was warranted.

The Firm's Failure to Implement its Low-Priced Securities Procedures to Detect Potentially Suspicious Trading Activity as to Individuals 2 and 3

Introducing Firm B was another introducing firm for whom Hilltop provided clearing services. Introducing Firm B had four accounts for Individual 2 and Individual 3. Together Individual 2 and Individual 3 were responsible for over 78% of Introducing Firm B's total low-priced securities volume and traded in 930 different low-priced

securities issuers during the AML Relevant Time Period. These trades were entered and executed through Introducing Firm B's order management system, which made it difficult for Hilltop to identify the number of orders Individuals 2 and 3 executed.

Many of the issuers of these securities had no material operations or revenues, and were the subject of promotional campaigns. Additionally, Individual 2's and 3's accounts' trading activity at times comprised over 50% of the material portion of daily trading volume[6] with certain orders occurring before market open (or close) at prices above the National Best Bid and Offer price. Taken together, this activity should have triggered red flags of potentially suspicious activity.[7]

Individual 2's five related accounts and Individual 3's account routinely appeared on the Firm's Daily Penny Stock Report ("DPS Report") between January and April 2016 with trading in the same securities. Furthermore, by mid-March 2016, the Firm learned that Individual 3 was allegedly involved in a manipulative trading scheme using convertible notes and that Individual 2, a former AMLCO, was sanctioned by FINRA for AML deficiencies involving low-priced securities.

Despite the Firm's awareness of red flags regarding the trading activity and the negative news regarding the individuals, the Firm failed to reasonably investigate the activity in the accounts. For example, Individual 3 heavily traded a technology stock between late January 2016 through mid-March 2016. At that time, the technology stock was delinquent on its financial statement disclosures to the SEC and was the subject of numerous paid promotional campaigns, including one in December 2015 just prior to Individual 3's activity. Individual 3's trading was between 50 and 100 percent of the total daily market volume on 15 of his 24 trading days (or 62 percent). Although the Firm's AML procedures identified market domination and marking the close/open as red flags of suspicious trading activity, requiring investigation, the Firm had no reports to assist analysts in detecting this activity.

In another example, Individual 2 heavily traded a development stage company between late January 2016 and later April 2016. At that time, the development stage company was eight years delinquent on its financial disclosures to the SEC. Individual 2's trading accounted for at least 60 percent of the daily trading volume on 10 of his 30 (33 percent) trading days, and over 90 percent on 5 of his 30 trading days (17 percent). Individual 2's trading also raised red flags due to the timing of his trades. During the AML Relevant Period, Individual 2 made 3,678 purchases of low-priced securities. The volume and timing of the trades presented red flags of potentially suspicious trading activity.

A Hilltop AML analyst reviewed activity in Individual 2 and 3's accounts, but did not detect any red flags, commenting in the DPS Report that "activity appears normal." The

[6] The Firm's procedures identified client activity representing more than 50 percent of the OTC bulletin board trading volumes to be a red flag.

[7] This activity triggered the following red flags from the Firm's procedures: (1) the company had no business, no revenue, and no product; (2) there was heavy coverage by stock promoters; and (3) the client activity represented more than 50 percent of OTC bulletin board trading volumes.

analyst looked for signs of market manipulation by reviewing trading volume for an individual account compared to the daily volume of the issuer. However, due to the volume of activity detailed in the DPS Report, the analyst was unable to perform detailed reviews. The analyst, therefore, failed to identify activity in accounts owned by the same household and never calculated the total volume of activity for those accounts.

3. Hilltop Failed to Devote Adequate Resources to its AML Program, Causing Potentially Suspicious Activity to be Overlooked.

Hilltop's failure to devote adequate resources to its AML program caused the Firm to have an unreasonable system for detection and reporting of suspicious activity. During the AML Relevant Period, the primary report used by the Firm's AML analysts to review low-priced securities transactions for red flags was the Firm's DPS Report. Analysts manually created the report daily, using the Firm's blotter – a process that took between one and one and half hours. The DPS Report identified trading and transfer activity in stocks priced under $1.00 where buys, sales, receipts, or delivery totaled at least 1,000 shares during the prior day. For those stocks, the DPS Report also provided a 90 day trading history and a 12 month receipt and delivery history. The information provided was generally limited to the issue, the number of shares, the price per share, and other information that could be extracted from the Firm's trading blotter. Although the Firm's procedures stated that research should be conducted when red flags were identified (e.g., incessant dilution, declining price with no material cause, history of reverse splits, heavy stock promotions), neither the DPS Report nor any other report was utilized to assist analysts in identifying these red flags.

Prior to the merger between Hilltop and First Southwest Company, LLC, the volume of the activity on the DPS Report for the prior 90 days was approximately 400 to 800 transactions. After the January 2016 merger, the number of daily low-priced securities transactions increased to approximately 250 transactions per day, and the 90-day activity reflected on the report increased to approximately 12,000 transactions on a rolling 90-day period. The increase in activity was primarily due to a half dozen actively traded accounts that transferred to Hilltop after the merger. During the AML Relevant Time Period, Hilltop had only two or three analysts assigned to review the DPS Report. Because of overall volume and lack of red flag indicators on the report, and the fact that trading data on the report changed daily, it was difficult for the Firm to identify and follow up on patterns of activity. The Firm was, thus, unable to use the report to conduct a reasonable review for potentially suspicious activity.

Specifically, prior to the merger, the Firm's analysts generally only reviewed transactions priced $0.01 or less and 1 million or more shares traded. Post-merger, Hilltop issued a compliance memo in January 2016 changing the general criteria for the sampling to activity where the shares were priced $0.50 cents or less and 1 million or more shares were traded. Nevertheless, the Firm's thresholds excluded 80% of the total value of penny stock transactions during the AML Relevant Time Period.

When the AML analysts selected a transaction for review, minimal analysis was performed, and the analysts' documentation of the review frequently failed to note any red flags identified or what steps, if any, were taken to investigate the red flags.

The lack of resources, both in terms of staff and systems, could not reasonably be expected to detect and cause the reporting of suspicious activity. The resource deficiencies contributed to the Firm's failure to detect the potentially suspicious trading activity engaged in by Individuals 2 and 3 discussed above. In addition, for 26 accounts with high volumes of low-priced securities, 16 of the accounts and seven of the 15 low-priced securities traded in those accounts received no AML reviews during the AML Relevant Period. A review of these transactions, however, indicate that at least 10 of the red flags specifically set forth in the Firm's procedures were present in these transactions.[8] Although the Firm's AML procedures required review of transactions when these red flags were present, no AML review was done.

As a result of the foregoing, Respondent violated FINRA Rules 3310(a) and 2010.

MSRB Rule Violations

B. Hilltop Failed to Submit Required Form G-32 Information.

MSRB Rule G-32(b)(i)(A) requires, among other things, an underwriter of a primary offering of municipal securities to submit Form G-32 information, and any other applicable documents and information relating to the offering, in a timely and accurate manner as required by the rule. In relevant part, MSRB Rule G-32(b)(i)(B) requires an underwriter of a primary offering of municipal securities to submit the official statement to EMMA within one business day after receipt from the issuer or its designee, but by no later than the closing date. Pursuant to MSRB Rule G-32(b)(i)(C), if an offering is exempted from the preparation of an official statement, the underwriter shall submit to EMMA, by no later than the closing date: (1) notice that no official statement will be prepared; and (2) the preliminary official statement (or notice that no preliminary official statement has been prepared). The required notices are to be made via Form G-32. Pursuant to MSRB Rule G-32(b)(ii), if a primary offering advance refunds outstanding municipal securities and an advance refunding document is prepared, each underwriter in the offering shall, by no later than five business days after the closing date, submit: the advance refunding document to EMMA, and submit required Form G-32 information regarding the offering in the manner required by the rule.

[8] Red flags present in these transactions included: (1) a pattern of receiving stock in physical form or the incoming transfer of shares, selling the position and wiring out proceeds; (2) companies experiencing frequent or continuous changes in its business structure; (3) customers who maintained multiple accounts, or maintained accounts in the names of family members or corporate entities with no apparent business or other purpose; (4) accounts for an associate or relative of a person with a history of securities violations; (5) certificates printed in recent months; (6) customers engaged in prearranged or other non-competitive trading of illiquid securities; (7) two or more accounts trade an illiquid stock suddenly and simultaneously; (8) trading patterns suggesting that the customer may have inside information; (9) a company that failed to make SEC or other regulatory filings; and (10) client activity representing more than 50 percent of OTC bulletin board trading volumes.

From July 2011 to October 2015, Hilltop failed to submit required Form G-32 information to EMMA in connection with 122 primary offerings of municipal securities for which the Firm served as placement agent. This failure was a result of a misunderstanding by one branch office of Southwest regarding the need to submit Form G-32 information for private placement primary offerings. Hilltop discovered these failures during its acquisition of Southwest and self-reported them to FINRA.

In addition, from January 2015 through March 2016, Hilltop also made four untimely Form G-32 filings to EMMA that were between 1 and 3 days late.

As a result of this conduct, Hilltop violated MSRB Rule G-32.

C. Hilltop Failed to Provide Rule G-17 Required Disclosure Letters.

MSRB Rule G-17 provides that "[i]n the conduct of its municipal securities activities, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice." The MSRB has opined that a dealer's affirmative disclosure obligations require that a dealer disclose, at or before the time of sale of municipal securities to a customer, all material facts concerning the transaction.[9] The MSRB had further opined that G-17 requires an underwriter to make certain written disclosures to a municipal issuer to clarify its role in an issuance of municipal securities and its actual or potential material conflicts of interest with respect to such issuance (commonly known as a "G-17 letter").

During the period from January 2012 to September 2015, Hilltop failed to provide required MSRB Rule G-17 letters to 119 of the issuers of the 122 offerings referenced above, plus one other issuer, as a result of its branch office's misunderstanding regarding private placement primary offerings.

Hilltop discovered these failures as it trained Southwest employees during its acquisition of Southwest and self-reported them to FINRA.

As a result of this conduct, Hilltop violated MSRB Rule G-17.

D. Hilltop Failed to Submit Required Form G-37 Information.

MSRB Rule G-37(e)(i) requires broker-dealers to send to the MSRB, by the last day of the month following the end of each calendar quarter, a Form G-37 that includes, among other things, lists of contributions to officials of issuers, payments to political parties of states and political subdivisions, contributions to bond ballot campaigns, and issuers with which the broker-dealer has engaged in municipal securities business. MSRB Rule G-37(e)(i)(C) requires the quarterly Form G-37 submission to list by state, the municipal entities with which the regulated entity has engaged in municipal securities business or

[9] See MSRB *Interpretive Notice Concerning The Application Of MSRB Rule G-17 To Underwriters Of Municipal Securities - August 2, 2012*.

municipal advisory business during such calendar quarter, along with the type of municipal securities business or municipal advisory business.

From October 2014 to September 2015, in connection with 45 of the 122 offerings for which Hilltop failed to submit G-32 information, the Firm also failed to report on Form G-37 that it had engaged in municipal securities business with the issuers by acting as placement agent in connection with the issuers' municipal securities offerings.

As a result of this conduct, Hilltop violated MSRB Rule G-37.

B. Respondent also consents to the imposition of the following sanctions:

1. A censure;

2. A fine in the amount of $475,000 ($100,000 of which pertains to the violations of MSRB Rules G-17, G-32 and G-37); and,

3. An undertaking to engage an Independent Consultant, pursuant to which Hilltop shall:

   a. Retain at its own expense one or more qualified independent consultants not unacceptable to FINRA, within 120 days of the date of the Notice of Acceptance of this AWC, to conduct a comprehensive review of the reasonableness of the Firm's policies, systems and procedures (written and otherwise) and training relating to compliance with FINRA Rule 3310 and the requirements of the Bank Secrecy Act, 31 USC §5311, *et. seq.,* and the regulations promulgated thereunder. This review shall include the Firm's policies, systems, and procedures relating to monitoring for, identifying, investigating, and responding to red flags of suspicious transactions with respect to low-priced securities.

      The Independent Consultant's review must include the period from at least April 1, 2016 through the date of the Notice of Acceptance.

   b. The Independent Consultant, any Firm with which the Independent Consultant is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties, shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, the Firm during the two years prior to the date of the Notice of Acceptance of this AWC.

   c. Cooperate with the Independent Consultant in all respects, including providing the Independent Consultant with access to the Firm's files, books, records, and personnel, as reasonably requested for the above-mentioned reviews. The Firm shall require the Independent Consultant to report to FINRA on its activities as FINRA may request and shall place no

restrictions on the Independent Consultant's communications with FINRA. Further, the Firm upon request, shall make available to FINRA any and all communications between the Independent Consultant and the Firm and documents reviewed by the Independent Consultant in connection with this review.

d. Once retained, the Firm shall not terminate the relationship with the Independent Consultant without FINRA's written approval; the Firm shall not be in and shall not have an attorney-client relationship with the Independent Consultant and shall not seek to invoke the attorney-client privilege or other doctrine or privilege to prevent the Independent Consultant from transmitting any information, reports or documents to FINRA;

e. At the conclusion of the Independent Consultant's review, which shall be no more than 180 days after the date of the Notice of Acceptance of this AWC, the Firm shall require the Independent Consultant to submit a written report ("the Initial Report") to it and FINRA. The Initial Report shall, at a minimum, address: (i) the adequacy of the Firm's policies, systems and procedures (written and otherwise) and training relating to compliance with FINRA Rule 3310 and the requirements of the Bank Secrecy Act, 31 U.S.C. § 5311, et. seq., and the regulations promulgated thereunder, related to monitoring for, identifying, investigating, and responding to red flags of suspicious transactions with respect to low-priced securities; (ii) a description of the review performed and the conclusions reached, and (iii) the Independent Consultant's recommendations for modifications and additions to the Firm's policies, systems, procedures and training with respect to low-priced securities; and

f. Within 60 days after delivery of the Initial Report, the Firm shall adopt and implement the recommendations of the Independent Consultant or, if it considers a recommendation to be, in whole or in part, unduly burdensome or impractical, propose an alternative procedure to the Independent Consultant designed to achieve the same objective. The Firm shall submit such proposed alternatives in writing simultaneously to the Independent Consultant and FINRA ("Firm's Proposed Alternative Procedures").

g. Within 30 days of receipt of any the Firm's Proposed Alternative Procedures, the Firm shall require the Independent Consultant to: (i) reasonably evaluate the alternative procedure(s) and determine whether it will achieve the same objective as the Independent Consultant's original recommendation; and (ii) provide the Firm and FINRA with a written decision reflecting its determination ("Written Report Regarding Alternative Procedures"). In the event the Independent Consultant and the Firm are unable to agree, the Firm must abide by the Independent

Consultant's ultimate determination with respect to any proposed alternative procedure and must adopt and implement all recommendations deemed appropriate by the Independent Consultant.

h. Within 30 days after the issuance of the later of the Independent Consultant's Initial Written Report or Written Report Regarding Alternative Procedures (if any), the Firm shall provide the Independent Consultant and FINRA staff with a written Implementation Report, certified by an officer of the Firm, attesting to, containing documentation of, and setting forth the details of the Firm's implementation of the Independent Consultant's recommendations. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. FINRA may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence.

i. Require the Independent Consultant to enter into a written agreement that provides that for the duration of this engagement and for a period of two years from the completion of this engagement, the Independent Consultant shall not enter into any other employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. Any Firm with which the Independent Consultant is affiliated or of which it is a member, and any person engaged to assist the Independent Consultant in the performance of its duties pursuant to this AWC, shall not, without prior written consent of FINRA, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent or any of Respondent's present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

j. Upon written request showing good cause, FINRA may extend any of the procedural dates set forth above.

Respondent agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. Respondent has submitted an Election of Payment form showing the method by which Respondent proposes to pay the fine imposed.

Respondent specifically and voluntarily waives any right to claim an inability to pay, now or at any time hereafter, the monetary sanction imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

Respondent specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

A. To have a Complaint issued specifying the allegations against Respondent;

B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;

C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and

D. To appeal any such decision to the National Adjudicatory Council (NAC) and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

Respondent understands that:

A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs (ODA), pursuant to FINRA Rule 9216;

B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and

C. If accepted:

1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future action brought by FINRA or any other regulator against Respondent;

2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;

3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and

4. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Respondent may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Respondent's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

D. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

The undersigned, on behalf of the Respondent Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that it has agreed to the AWC's provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce Respondent to submit it.

June 15, 2020
Date

Hilltop Securities, Inc., Respondent

By: _____

Print Name: Mike Cogliano

Title: CCO

Reviewed by:

Gerald J. Russello/gr

Gerald J. Russello
Sidley Austin LLP
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787 Seventh Avenue
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Accepted by FINRA:

July 28, 2020

Date

Signed on behalf of the
Director of ODA, by delegated authority

Laura L. Blackston

Laura Leigh Blackston, Senior Counsel
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THE STATE OF TYPICAL DEFENSES AND TACTICS USED BY BROKER-DEALERS IN FINRA ARBITRATION

Robert J. Girard II

INTRODUCTION

The FINRA Dispute Resolution Task Force asserts that "Dispute Resolution is committed to providing a fair, efficient, and economical forum to resolve disputes among investors, securities firms, and individual brokers," and the FINRA *Code of Arbitration Procedure* assists in protecting claimants, and more specifically investors, by ensuring that claimants are not bullied by typical defense tactics, such as the use of motions to dismiss. Other typical defenses that "blame the victim" or "blame the market" are heavily impacted by the state of the securities industry, public opinion and the efficacy of expert testimony, factors that can render a typical defense viable or wholly unsustainable in equal measure. While FINRA-DR awards tend to be sparse and unreasoned (and thus defensible against a motion to vacate in court), how a claimant pleads certain causes of action may impact a respondent's ability to attack an award if the panel relies upon FINRA Rule violations to award damages. While many theories of liability and their concomitant defenses are tried and true, new FINRA Rules and guidance may establish new grounds for liability that have yet to be fully developed. Familiarity with both sides of the litigation "coin" can be a valuable tool when evaluating strategies and the strengths and weaknesses of a claim.

MOTIONS TO DISMISS

No one can deny that FINRA Dispute Resolution abhors motions to dismiss prior to the conclusion of a party's case in-chief[1]: FINRA *code of Arbitration Procedure* ("Code") and guidance is littered with admonitions that "parties have the right to a hearing in arbitration … [and] motions to dismiss filed prior to the conclusion of a party's case in chief, including prehearing motions, are discouraged in arbitration." *See* FINRA Dispute Resolution Services "Motion to Dismiss and Eligibility Rules FAQ" ("MTD FAQ"); *see also* FINRA *Code of Arbitration Procedure* 12504(a)(1). There are provisions in the *Code* for bringing a pre-hearing motion to dismiss as a sanction for a party's failure to comply with the Code or a panel's order (Codes 12212; 12504(d)) or for engaging in discovery abuse (Codes 12511; 12504(e)), but they are deterrents of bad behavior and not a proactive means to dispense with a case.

In fact, FINRA goes much further than merely "discouraging" pre-hearing motions to dismiss; it has codified unyielding parameters for bringing such a motion, and laid out consequences for bringing an unsuccessful one. Thus, while FINRA has not outright prohibited motions to dismiss, it has curtailed them to such a degree that it is rarely worthwhile to bring a motion to dismiss before the hearing. Whereas motions to dismiss can often be used as a litigation tactic by parties looking to raise costs and push for an early low-dollar settlement, in the FINRA-DR forum, the effect is flipped on its head – the costs are borne by the moving party, who faces penalties if the motion is denied, making pre-hearing filing impractical and costly.

[1] A motion to dismiss after the conclusion of a party's case in-chief is not hindered by the same constraints as those pre-hearing. *See* FINRA *Code of Arbitration Procedure* 12504(b).

While FINRA is able to deny claims *ab initio* under other *Code* sections,[2] FINRA requires a case to move forward so a motion to dismiss may be heard by the full panel, meaning the statement of claim has been processed, the opposing party has filed an answer, the initial pre-hearing conference has been held and the arbitrators have been empaneled. FINRA *Code of Arbitration Procedure* 12504 and 12206. In addition, there are strict constraints placed upon the panel when a motion to dismiss is brought: the motion to dismiss must be heard by the entire panel, oral argument[3] must be presented and recorded, the decision must be unanimous and a written explanation must be provided. FINRA *Code of Arbitration Procedure* 12206(b)(1)-(5); FINRA *Code of Arbitration Procedure* 12504(a). Not only has FINRA limited the grounds upon which a Panel may grant a motion to dismiss to four very narrow, very fact-specific grounds, it has intentionally stripped the panel of any authority to act equitably, a fundamental aspect of the FINRA-DR forum.

A panel "shall not" grant a motion to dismiss prior to hearing the claimant's case in-chief unless it falls under one of the following four (4) grounds:

(1) the non-moving party previously released the claim(s) in dispute by a signed settlement agreement and/or written release;
(2) the moving party was not associated with the account(s), security(ies) or conduct at issue;
(3) the non-moving party previously brought a claim regarding the same dispute against the same party that was fully and finally adjudicated on the merits and memorialized in an order, judgment, award, or decision; or
(4) the claim does not meet the criteria of *Code* 12206's "eligibility rule," *i.e.*, the claims giving rise to the case are six or more years old.

FINRA *Code of Arbitration Procedure* 12206(a) and 12504(a)(6). Considering these narrow confines, appropriate grounds for a motion to dismiss are hard to come by. This bolsters FINRA's commitment to protecting a claimant's right to be heard and severely cuts into a respondent's arsenal of defenses against proceeding to hearing.

Moreover, under Code 12504(a), if a panel denies the motion, not only is the movant forbidden from re-filing the denied motion (unless explicitly permitted by the panel), FINRA penalizes the movant by requiring the panel to asses all forum fees "associated with [the] hearings" against the moving party. FINRA *Code of Arbitration Procedure* 12504(a)(8) and 12504(a)(9). Thus, FINRA makes filing a pre-hearing motion to dismiss a gamble if there is not glaring proof that one of the four grounds above applies.

As a further deterrent to filing a pre-hearing motion, if the panel denies the motion and determines it was frivolous, "the panel must also award reasonable costs and attorneys' fees to any party that

[2] There are other *Code of Arbitration Procedure* sections that preclude the submission of a claim to FINRA-DR jurisdiction, such as, by way of example, section 12204's Class Action Claims and section 12205's Shareholder Derivative Claims. If these issues are obvious on the face of the statement of claim, the statement of claim may not even be processed by FINRA, as the Director of FINRA-DR has discretion to "decline to permit the use of the FINRA arbitration forum if the Director determines that, given the purposes of FINRA and the intent of the Code, the subject matter of the dispute is inappropriate, or that accepting the matter would pose a risk to the health or safety of arbitrators, staff, or parties or their representatives." FINRA *Code of Arbitration Procedure* 12203(a).

[3] The parties may waive oral argument, but the Code section is written in the plural, i.e., both parties must waive oral argument. FINRA *Code of Arbitration Procedure* 1206(b)(4) and 12504(a)(5).

opposed the motion." Interestingly, the panel may also issue other sanctions under Code 12212 if it determines that the motion was filed in "bad faith." There is no indication that there is a distinction between "frivolous" and "bad faith," but it may allow the panel a bit more flexibility in crafting an appropriate penalty for bringing a pre-hearing motion.

1) The "Eligibility Rule"

FINRA *Code of Arbitration Procedure* 12206, the "Eligibility Rule," is FINRA's version of a statute of limitation: "[n]o claim shall be eligible for submission to arbitration under the Code where six years have elapsed from the occurrence or event giving rise to the claim." This does not preclude a respondent from arguing that a shorter state or federal statute of limitations applies, however, in FINRA, a shorter statute of limitations will not prevent the claim from moving forward if the occurrence upon which the claims are predicated falls short of the six-year limitation. MTD FAQ. Significantly, even if a motion to dismiss is granted pursuant to the Eligibility Rule, "[d]ismissal of a claim under this rule does not prohibit a party from pursuing the claim in court. ***By filing a motion to dismiss a claim under this rule, the moving party agrees*** that if the panel dismisses a claim under this rule, ***the non-moving party may withdraw any remaining related claims without prejudice and may pursue all of the claims in court***." FINRA *Code of Arbitration Procedure* 12206(b) (emphasis added). In other words, by merely filing a motion to dismiss based upon the Eligibility Rule, the moving party is consenting to move the action to court.[4]

FINRA's restrictions on pre-hearing motions to dismiss render them costly and ineffectual as litigation tactics, unless the evidence leaves no doubt whatsoever that the claims were released prior to filing, the claimant sued the wrong party, or the claimant already adjudicated "the same dispute against the same party [and] that was fully and finally adjudicated on the merits and memorialized in an order, judgment, award, or decision." FINRA *Code of Arbitration Procedure* 12504(a)(6)(C). With such limitations, there can be no tactical advantage to filing a motion to dismiss in the FINRA-DR forum.

DEFENSES REGARDING THE WELL-MANAGED PORTFOLIO / MARKET ADJUSTED DAMAGES

"Respondents typically argue that only 'actual losses' are compensable and that 'what if' calculations are impermissibly speculative."[5] In the FINRA-DR forum, however, "what if" damages are regularly demanded and awarded. The "well-managed portfolio" theory ("WMP") or "market adjusted damages," calculates damages by using a model based upon "how a rational investor would use diversification and asset allocation to optimize their portfolio for their particular risk profile and circumstances."[6] The WMP theory of damages is used to calculate the "maximum

[4] *Cf., Leith v. Berthel*, No. C088365, 2020 Cal. App. Unpub. LEXIS 1754 (Mar. 17, 2020), wherein the appellate court found that the claimants/plaintiffs had expressly waived their right to arbitrate when they "voluntarily abandoned their pending FINRA arbitration claims" by stipulating to dismissal in favor of proceeding in a judicial forum after respondents/defendants threatened to file a motion to dismiss under the Eligibility Rule. The court held that the fact that the stipulation was "without prejudice" was of no consequence.

[5] Fazio, J., "*Hypothetically Speaking: an Introduction to Well-Managed Account Analysis,"* Practicing Law Institute (2007), p. 1.

[6] Port, R., *Daubert, the "Well Managed Portfolio," and "Net-Out-of-Pocket (NOP) Losses: Are NOPs Junk Science?"* 21 PIABA L. J. 2, p. 151 (2014).

possible expected return for a given level of risk. Thus, it is possible to create a portfolio to match an individual investor's risk-reward tolerance."[7]

This theory of damages is susceptible to attack:

> Criticisms include the fact that actual financial returns do not follow a normal distribution; that correlations between asset classes are not fixed but can vary depending on external events; that MPT neglects taxes and transaction costs; that investors may not be entirely rational; and that markets are not completely efficient. The utility of MPT was also questioned during the 2008 financial crisis, in which even most diversified investment portfolios suffered significant losses.[8]

Despite the criticisms, some hold that this theory of damages is more accurate than a "net-out-of-pocket" theory of damages,[9] which calculates damages by reviewing the cash and securities deposited, less the cash and securities withdrawn and closing equity equals the gain or loss, or a "trade for trade" analysis.[10] WMP requires a detailed analysis of every gain and loss, which leaves it susceptible to attack should not all of the necessary entries be identified and accounted for.[11]

Theoretically, WMP can be used to establish the progress of a diversified portfolio for every risk level, with the premise that diversification is necessary, as "[d]iversity has long been held to be a duty of a trustee or fiduciary managing assets."[12][13]

1) The Contradictions of a Bull vs. Bear Market

Ironically, when considering a well-managed portfolio analysis, a "bull" market (when share prices are on the rise and the securities industry is doing well) is generally not in an industry-respondent's best interest, and a "bear" market (when share prices are decreasing and the securities industry is feeling pinched) is generally not in an investor-claimant's best interest, even though it is during a "bear" market that investors' portfolios tend to lose value. Here is a simple example from a well-known expert:

> Bear Market Example: The actual account lost $150; the market was down $100; the market-adjusted loss is $50.

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[7] *Id.*

[8] *Id.* at p. 152, fn. 6, *citing* Markowitz, H., *"Crisis Mode: Modern Portfolio Theory Under Pressure*," 2 Investment Prof., no. 2 (Spring 2009).

[9] *Id.*, pp. 151-152.

[10] Fazio, *Hypothetically Speaking.*

[11] *Id.*

[12] Port, *Daubert, the "well Managed Portfolio,"* p. 153.

[13] For a detailed an excellent analysis of the Market Adjusted Damages theory in the FINRA, please see Adikoff, P., Uhl, B., and Bakhtiari, R., *Market Adjusted Damages in the FINRA Forum*, 21 PIABA L. J. 2, p. 137 (2014).

Bull Market Example: The actual account lost $150; the market was up $100; the market-adjusted loss is $250.[14]

Further, "[c]ash is an investment on which interest is earned, but cash and cash equivalents are insulated from the stock market. All things being equal, in a bull market an account with cash will under perform an account that is fully invested; in a bear market, the account with cash will outperform an account that is fully invested."[15] Thus, while lawsuits will undoubtedly experience an uptick during bear markets, a WMP theory is more fruitful during a bull market.

2) Account Objectives and Risk Tolerance

Respondents regularly rely upon the written account forms to show that an investor's risk tolerance and investment objectives were sufficient to justify decisions to buy and sell and that the activity was suitable based on the written disclosures, whereas a claimant may argue that the written information is incorrect, out of date or that the claimant misunderstood the form or the verbal instructions provided by the broker. Many times, this "he said, she said" regarding a customer's actual objectives and risk tolerance will hinge upon witness testimony and not the account documentation.[16]

3) The "What Ifs"

Using a WMP analysis bolsters a claim for "what if"/speculative damages, as a party may use the analysis to argue that a change to the portfolio should have been made and the failure to do so caused the damages. A broker may argue either that the shift would not have made a difference or that he advised the customer to change the portfolio, but the customer failed to listen. Without strong evidence supporting the WMP analysis, *e.g.*, evidence that the broker knew or should have known to make the change and/or that the market clearly showed a detrimental shift on the raise, the analysis may appear to be speculative.[17]

The flip side to this is a claimant's argument that the original portfolio was appropriate for the customer and it was the changes the broker recommended that were inappropriate – the "undisturbed portfolio" would not have suffered the damages incurred. As a corollary, a respondent may offer a "reverse mitigation" argument, namely that it was the customer's selling of an investment that caused the losses, and had the customer held the securities instead, the losses could have been avoided.[18]

While these arguments may be generally associated with the respondent or claimant, there are times when it is a party's best interest to coopt an opposing party's typical argument: a respondent may prepare an "undisturbed portfolio" analysis to show that holding the original portfolio would have resulted in greater losses, and a claimant will prepare the "what if" analysis to show that if the new portfolio were held, it would have resulted in greater losses. This is all the more reason

[14] Fazio, J., *Hypothetically Speaking, supra,* p. 2.

[15] *Id.*

[16] *Id.*

[17] *Id.*

[18] *Id.*

for each side to understand the opposing argument, just in case an argument can be "hijacked" to support one's own claims.

DEFENSES REGARDING VIOLATIONS OF FINRA RULES IN ARBITRATION AWARDS

Generally, FINRA-DR awards are devoid of any written explanation unless specifically requested by the parties, but often awards include references to FINRA Rule violations, even if it is an unreasoned award. Courts have held that there is no private cause of action for a violation of a FINRA Rule,[19] however, FINRA Rule violations are often pled in FINRA-DR customer cases and have formed the basis for recovery. While there is a general consensus that FINRA Rules may establish a standard of care, such as FINRA Rule 2010 ("a member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade"), outside of the FINRA-DR forum, Rule violations themselves hold no sway.

FINRA enforcement actions have held that "FINRA Rule 2010 is sufficiently broad to encompass any unethical, business-related misconduct, regardless of whether it involves a security." *Dep't of Enforcement v. Olson,* 2014 FINRA Discip. LEXIS 7, at *7 (FINRA May 9, 2014), *citing Daniel D. Manoff* (2002) 55 S.E.C. 1155, 1162 (2002); *see also*, *Timothy L. Burkes* (1993) 51 S.E.C. 356, *aff'd mem., Burkes v. SEC* (9th Cir. 1994) 29 F.3d 630 (Rule 2010 states a broad ethical principle that is not limited to rules of legal conduct). "The analysis that is employed [under Rule 2010] is a flexible evaluation of the surrounding circumstances with attention to the ethical nature of the conduct." *Dep't of Enforcement v. Shvarts,* Complaint No. CAF980029, 2000 NASD Discip. LEXIS 6, at *15 (NASD NAC June 2, 2000).

By extension, violations of other FINRA Rules also set a standard of conduct, and courts have recognized that a Rule violation may be the basis for a breach of standard of care.[20] But the actual Rule violation itself may not be the basis for a private cause of action. *See, e.g., Brady v. Calyon Sec. (USA)*, 406 F. Supp. 2d 307, 312 (S.D.N.Y. 2005) ("While defendants may be subject to the rules and by-laws of NYSE and NASD, the rules of NYSE and NASD do not confer a private right of action").

There is an underlying issue that is currently pending before a court that may have far reaching consequences within FINRA-DR:

> **If a FINRA panel notes in the award that there was a FINRA Rule violation, is that sufficient grounds to vacate the award if the damages were predicated upon the violation and not a standard of care?**

As an example, if a claimant pleads that a member-firm has violated new FINRA Rule 2165 – the Financial Exploitation of Specified Adults – and the panel includes in the award that the Rule was violated but fails to state that the conduct was <u>also</u> in violation of applicable law, is the award

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[19] *See, e.g., Gurfain v. Ameritrade, Inc.*, 312 Fed. App'x 410, 414 (2d Cir. 2009); *Velasquez v. HSBC Mortg. Servs*., 2009 U.S. Dist. LEXIS 68473, at *10 (D. Nev. July 24, 2009) (*citing Wells v. Blythe & Co.*, 351 F. Supp. 999 (N.D. Cal. 1972)); *Brady v. Calyon Sec. (USA)*, 406 F. Supp. 2d 307, 312 (S.D.N.Y. 2005); *SSH Co., Ltd. v. Shearson Lehman Bros., Inc.*, 678 F. Supp. 1055, 1058 (S.D.N.Y. 1987).

[20] *See, e.g., Rioseco v. Gamco Asset Management, Inc*., 2011 N.Y. Misc. LEXIS 7279 at * 79 (Sup. Ct. N.Y. 2011) (claimants can plead a negligence claim for failure to adhere to the standards of care established by the FINRA rules).

susceptible to vacatur if the respondent argues there is no private cause of action for a rule violation?

In a recent case before the United States Court of Appeals for the 4th Circuit, the court has been asked to rule upon whether it was proper for the underlying court to vacate a FINRA arbitration award for the panel's reliance upon a FINRA Rule violation to award damages and dismiss a counterclaim on a theory of "manifest disregard of the law." *Interactive Brokers LLC v. Saroop*, No. 3:17-cv-127, 2018 U.S. Dist. LEXIS 214023, 2018 WL 6683047 (E.D. Va. Dec. 19, 2018). The underlying court held that, while FINRA rules may be used to define the scope of a common law duty or to provide evidence of whether that duty was met, a violation of FINRA Rules may not, standing alone, establish "the predicate for liability in the first place."

The underlying opinion of the Virginia Eastern District Court can certainly be read as a disgruntled judge who was offended that the panel failed to provide a fully-reasoned award upon remand (which, under most well-accepted authority, it had no obligation to do),[21] but the court attempted to distinguish between relying upon the Rule violation as a breach of a standard of care and a Rule violation that led to an award of damages irrespective of the standard of care. In the underlying arbitration, the FINRA-DR panel found that, pursuant to FINRA Rule 4210 ("Margin Requirements") and Regulatory Notice 08-09 ("FINRA Revises Portfolio Margining Risk Disclosure Statement and Written Acknowledgment for Customers Using Portfolio Margin Accounts,"), "the securities placed in the portfolio margin account were not eligible for that account" and based the claimants' damages on the rule violation. The panel also dismissed Interactive Broker's counterclaim for violating Rule 4210. FINRA Award 15-03035.

PIABA's 2019 Amicus Brief noted that FINRA *Code of Arbitration Procedure* does not require a customer to plead a rule of law nor a FINRA Rule violation to be viable in the FINRA-DR forum. Moreover, PIABA noted that FINRA arbitrators have the authority to award damages based upon rule violations or even causes of action that do not exist outside of the securities industry:

> It is also important to understand that, independently of what the parties submitted to the arbitrators, and despite the predictable refrain from the industry, FINRA *says customers can rely on rule violations to support arbitration claims*. According to FINRA's predecessor, in arbitration, "[y]ou do not have to have a claim that is cognizable under NASD rules." Fienberg Remarks to NASAA [citation]. Ms. Fienberg also said: You can also assert in your arbitration claim violation of [FINRA] rules. For example, suitability. There's no statutory claim for suitability. That's a [FINRA] rule. It's much easier to assert and then prevail [on that kind of claim]."

(Emphasis in original). In response to the court's remand, the FINRA panel stated, "Respondent's position that the Panel should not enforce a FINRA rule amounts to saying that FINRA should provide an opportunity for investors to commit financial suicide by investing in securities that are ineligible for inclusion in a portfolio margin account. To ignore a FINRA rule by the Panel would defeat the purpose of FINRA."

The panel's flippant response to the remand almost assuredly added to the court's foment and its recalcitrant stance on vacating the award, but overturning its decision is not necessarily a given.

[21] Although the award was a typical unreasoned FINRA award, "the Court remanded the matter to the same panel of arbitrators for clarification as to the predicate for liability, how the damages were determined, and the basis for attorney's fees." (p. 11 of Opinion).

In another case, a New York court essentially held that, as long as the panel does not *cite* to a Rule violation as the basis for the award, it would not constitute "manifest disregard of the law." In *Grace Financial Group, LLC v. Dino*, 31 N.Y.S.3d 472 (N.Y. App. Div. 2016), the court held that the award "does not exhibit a manifest disregard of this law, since it characterizes respondents' claim as asserting only 'excessive fees and mark-ups' … and it does not refer to the NTM or FINRA rules." The court further noted:

> Although the motion court erred to the extent it concluded that the underlying account agreements between petitioner and each respondent incorporate FINRA rules by reference and therefore form a basis for a viable breach of contract claim (*see Gurfein,* 312 Fed.Appx. at 413, 2009 WL 485062), the motion court correctly noted that petitioner's claim is essentially an "overcharge claim." The statements of claim and other submissions expressly considered by the arbitrator, state that petitioner had charged respondents excessive fees, without notice and contrary to a previously negotiated fee schedule. This claim sufficed as a "barely colorable basis" for the award [citations].

While most FINRA-DR awards are devoid of written explanation or reasoning and therefore do not specify whether a damages award is predicated upon a breach of a standard of conduct or a FINRA Rule violation, these cases do call into question whether a claimant's initial pleading should address a distinction between the two, and whether a respondent's rebuttal, that there is no cause of action that could arise outside of the Rule violation itself, is a viable defense.

FINRA RULE 2165 – FINANCIAL EXPLOITATION OF SPECIFIED ADULTS

FINRA has been keenly aware of the United States' aging population for some time. In 2017, FINRA Dispute Resolution instituted a national program to expedite the administration of arbitration proceedings in matters involving elderly or seriously ill parties.[22] In the same year, the SEC approved the adoption of new FINRA Rule 2165 (Financial Exploitation of Specified Adults) that permits member-firms to place a temporary hold on disbursements from the accounts of specified customers where there is a "reasonable belief of financial exploitation," and amendments to FINRA Rule 4512 (Customer Account Information) that requires member-firms to make "reasonable efforts" to obtain the name and contact information for a "trusted contact" person for a customer's account. New FINRA Rule 2165 and the amendments to Rule 4512 became effective February 5, 2018.

FINRA Rule 2165 has a "safe harbor" provision to allow firms ***discretion*** to place temporary holds on disbursements if there appears to be abuse of an elderly person (65+) or a person who is 18 or older "who the member reasonably believes has a mental or physical impairment that renders the individual unable to protect his/her own interests." FINRA Rule 2165. It does not, however, allow a firm to place a temporary hold on a securities transaction. "Frequently Asked Questions Regarding FINRA Rules Relating to Financial Exploitation of Senior Investors." In addition, "FINRA emphasizes that a member may not avail itself of the Rule 2165 safe harbor if it blocks disbursements where there is not a reasonable belief of financial exploitation regarding such disbursements." *Id.*

[22] *See Arbitrator's Guide* (Feb. 2017) p. 23 "Part Four: Before the Proceedings Begin – Determine Whether There is a Senior or Seriously Ill Party Involved."

Currently, it appears litigators in the FINRA-DR forum see this as a compliance issue rather than grounds for a cause of action. Since the Rule is discretionary and a purported "safe harbor" for member-firms, it may be some time before arbitration claims are made that reflect a violation, if at all, and, as discussed in more detail below, a Rule violation in and of itself does not provide a private cause of action for a wronged investor.[23] When allegations are made based upon a violation, there will be some unanswered questions:

1. Did this Rule create a new fiduciary duty for firms, despite the "safe harbor" language in the Rule?
2. Is there liability for placing an unnecessary hold that resulted in avoidable losses?
3. Is there liability for not placing a hold when there is blatant financial exploitation and the account suffers losses?
4.

Integral to FINRA Rule 2165 is the amended FINRA Rule 4512, which requires, at the time of opening the account, the firm make "reasonable efforts" to obtain information for a "Trusted Contact Person."[24] "The trusted contact person is intended to be a resource for the firm in administering the customer's account, protecting assets and responding to possible financial exploitation or diminished capacity. FINRA notes that firms are not prohibited from opening and maintaining an account if customers fail to identify a trusted contact person, as long as they make reasonable efforts to obtain the information. FINRA "Protecting Senior Investors 2015–2020," (Apr. 30, 2020). Rule 4512(a)(1)(F) requires that the Trusted Contact Person be a natural person age 18 or older; therefore, a customer could designate a lawyer as a Trusted Contact Person, but not the lawyer's law firm. "Frequently Asked Questions Regarding FINRA Rules Relating to Financial Exploitation of Senior Investors."

While generally account information is deemed confidential, the Rule allows for dissemination of account information to a Trusted Contact Person. "[C]onsistent with Supplementary Material .06(a) to Rule 4512, the member or an associated person is authorized to contact the trusted contact and disclose information about the customer's account to address possible financial exploitation, to confirm the specifics of the customer's current contact information, health status, or the identity of any legal guardian, executor, trustee or holder of a power of attorney, or as otherwise permitted by Rule 2165. As the SEC noted in its approval order, moreover, a member's communications made pursuant to the trusted-contact provision would be consistent with Regulation S-P … because such disclosures would be made with the customer's consent or authorization, to protect against fraud or unauthorized transactions, or to comply with federal, state, or local laws, rules and other applicable legal requirements." *Id.*

FINRA has set the bar fairly low for making "reasonable efforts": "[a]sking a customer to provide the name and contact information for a trusted contact (*e.g.*, in an account opening form) constitutes reasonable efforts to obtain the information and satisfies the Rule 4512 requirements." *Id.* Even with such a *de minimus* "reasonable efforts" standard, there still may be questions as to whether the firm's efforts were sufficient. More interesting is whether firms will pursue third-party liability claims if a "Trusted Contact Person" is responsible for avoidable losses, and/or whether

[23] *See, e.g., Gurfain v. Ameritrade, Inc.*, 312 Fed. App'x 410, 414 (2d Cir. 2009); *Velasquez v. HSBC Mortg. Servs*., 2009 U.S. Dist. LEXIS 68473, at *10 (D. Nev. July 24, 2009) (*citing Wells v. Blythe & Co.*, 351 F. Supp. 999 (N.D. Cal. 1972)); *Brady v. Calyon Sec. (USA)*, 406 F. Supp. 2d 307, 312 (S.D.N.Y. 2005); *SSH Co., Ltd. v. Shearson Lehman Bros., Inc.*, 678 F. Supp. 1055, 1058 (S.D.N.Y. 1987).

[24] Because the Rules are designed to protect elderly individuals, the Rules specifically apply only to non-institutional accounts.

firms could seek indemnity from the Trusted Contact Person if that person failed to act after being put on notice that there may be a financial exploitation issue.

Although the Rules appear to limit a firm's liability through Rule 2165's "safe harbor" and discretionary nature and Rule 4512's meager "reasonable efforts," if the Rules establish an affirmative duty and standard of care, they may yet provide grounds for liability.

Motion to Dismiss and Eligibility Rules FAQ

What is a motion to dismiss?
A motion to dismiss is a request made by a party to the arbitrator(s) to remove some or all claims raised by another party filing a claim. Rule 12504 of the Code of Arbitration Procedure for Customer Disputes and Rule 13504 of the Code of Arbitration Procedure for Industry Disputes (collectively, the Codes) establish procedures that govern motions to dismiss.

Procedures Relating to Motions to Dismiss
Procedures that specifically address motions to dismiss are listed below:

- Parties must file the motions in writing, separately from the answer, and only after they file the answer.
- Parties must file any Rule 12504(a) motion at least 60 days in advance of a hearing.
- Parties will have 45 days to respond to a Rule 12504(a) motion.
- In the case of an eligibility motion, parties must file any motion to dismiss at least 90 days before a hearing, and the other parties will have 30 days to respond.
- The full panel will decide a Rule 12504(a) motion and an eligibility motion.
- The panel cannot act upon a motion to dismiss a party or claim under Rule 12504(a), unless the panel determines that: (1) the non-moving party signed a settlement and release; (2) the moving party was not associated with the account, security or conduct at issue; or (3) the non-moving party previously brought a claim regarding the same dispute against the same party that was fully and finally adjudicated on the merits and memorialized in an order, judgment, award, or decision.
- The panel cannot act upon a motion to dismiss a party or claim under Rule 12206(b), unless the panel determines that the claim is not eligible for arbitration because it does not meet the six-year eligibility requirement.
- If a party files a motion to dismiss on multiple grounds, including eligibility, the panel must decide eligibility first. If the panel grants the motion on eligibility, it must not rule on any other grounds for the motion.
- The panel must hold a hearing before it grants a Rule 12504(a) motion, unless the parties waive the hearing.
- If the panel grants a Rule 12504(a) motion, the decision must be unanimous and be accompanied by a written explanation.
- If the panel denies a Rule 12504(a) motion, a party may not re-file it, unless specifically permitted by panel order.
- If the panel denies a Rule 12504(a) motion, the panel must assess forum fees against the party who filed the motion.
- If the panel deems a Rule 12504(a) motion frivolous, it must also award reasonable costs and attorneys' fees to the party who opposed the motion.
- If the panel determines that a party filed a motion to dismiss under Rules 12206(b) and 12504(a) in bad faith, it may issue other sanctions under Rules 12212 and 13212 of the Codes.

How do Rules 12054 and 13504 affect motions to dismiss filed in FINRA's arbitration forum?
Rules 12504(a)(1) and 13504(a)(1) reinforce FINRA's position that parties have the right to a hearing in arbitration by clarifying that motions to dismiss filed prior to the conclusion of a party's case in chief, including prehearing motions, are discouraged in arbitration. The rules significantly limit motions to dismiss filed prior to the conclusion of a party's case-in-chief. Under the rules, the panel cannot act upon a motion to dismiss a party or claim, unless the panel determines that: (1) the non-moving party previously released the claim(s) in dispute by a signed settlement agreement and/or written release; (2) the moving party was not associated with the account(s), security(ies) or conduct at issue; (3) the non-moving party previously brought a claim regarding the same dispute against the same party that was fully and finally adjudicated on the merits and memorialized in an order, judgment, award, or decision; or (4) the claim does not meet the criteria of the eligibility rule.

How should arbitrators apply the four exceptions?

Prior settlement or release

A panel cannot act on a motion to dismiss under Rules 12504(a)(6)(A) and 13504(a)(6)(A) unless the panel determines that the non-moving party previously released the claims in dispute by a signed settlement agreement and/or written release. Parties seeking this exception should provide arbitrators with valid documents that indicate that the claims in the current dispute have been resolved in a previous dispute.

Not associated with the account, security or conduct at issue

A panel cannot act on a motion to dismiss under Rules 12504(a)(6)(B) and 13504(a)(6)(B) unless the panel determines that the moving party was not associated with the accounts, securities or conduct at issue. FINRA intends this exception to apply in cases involving issues of misidentification. For example, the panel could grant a motion to dismiss under this exception if a party files a claim against the wrong person or entity, or a claim names an individual who was not employed by the firm during the time of the dispute.

A claim regarding the same dispute against the same party that was fully and finally adjudicated on the merits and memorialized

A panel may grant a motion to dismiss relating to a particular controversy if they believe the matter was adjudicated fully even in instances where a claimant adds a new cause of action, or adds additional facts. For example, consider a case where a claimant initiated a claim against a firm for $150,000 for suitability based on a broker's investment in XYZ stock. The arbitrators dismiss the claim after a full hearing. This exception allows arbitrators to hear a motion to dismiss if the claimant subsequently files an arbitration against the same firm relating to the investment in XYZ but in the new case the claimant alleges fraud in inducing the claimant to make the purchase.

Eligibility

A panel may grant a motion to dismiss on eligibility grounds at any stage of the proceeding under Rules 12206(b)(7) and 13206(b)(7), including a prehearing motion, if the claim is not eligible for submission to arbitration because six years have elapsed from the occurrence or event giving rise to the claim. Parties seeking this exception should provide arbitrators with valid documents that indicate when the occurrence or event took place.

FINRA emphasizes that these exceptions do not constitute an invitation to parties to file motions to dismiss. The fact that a motion may be filed under one of these exceptions does not mean that the panel should or will grant a motion that does not have merit.

How should a party file a Rule 12504(a) motion?
If a party wishes to file a Rule 12504(a) motion, the party must file the motion in writing, file it separately from the answer and file it only after the answer is filed. For a Rule 12504(a) motion, the party filing the motion must serve the other parties and the Director of Arbitration with the motion at least 60 days before a scheduled hearing. The parties receiving the Rule 12504(a) motion will have 45 days to respond to the motion.

Are there procedures that a panel must follow to decide a Rule 12504(a) motion?
Yes. The full panel must decide a Rule 12504(a) motion. Moreover, the panel may not grant a Rule 12504(a) motion unless an in-person or telephone prehearing conference on the motion is held or waived by the parties. In addition, prehearing conferences to decide these motions will be recorded.

What happens if the panel grants a Rule 12504(a) motion?
If the panel grants a Rule 12504(a) motion (in whole or part), the decision must be unanimous and accompanied by a written explanation. FINRA believes that the type of relief requested by a Rule 12504(a) motion—the complete dismissal of a claim before an evidentiary hearing is completed—justifies the requirement that all arbitrators on the panel agree, based on the evidence presented by the party filing the motion, that the motion should be granted.

What happens if the panel denies a Rule 12504(a) motion?
If a panel denies a Rule 12504(a) motion, a panel must assess forum fees associated with the hearing(s) on the motion against the party who filed the Rule 12504(a) motion. The panel decision to deny a Rule 12504(a) motion is not required to be unanimous.

FINRA believes that the mandatory assessment of forum fees will deter parties from filing Rule 12504(a) motions that are not meritorious or that fall outside the scope of the three exceptions, and will provide an incentive for parties wishing to file such motions to ensure that their motions to dismiss filed prior to the conclusion of a party's case in chief, including prehearing motions, comply with the intent of the rules.

May a party re-file a Rule 12504(a) motion that has been denied?
A party may not re-file a Rule 12504(a) motion that has been denied, unless specifically permitted by panel order. The panel decision to re-file a Rule 12504(a) motion is not required to be unanimous.

What happens if the panel determines that a party has filed a motion to dismiss frivolously?
If a panel determines that a party filed a Rule 12504(a) or eligibility motion frivolously, the panel must also award reasonable costs and attorneys' fees to any party that opposed the motion. FINRA believes that the risk of monetary penalties and sanctions, imposed either by the panel on its own initiative, or as a result of a party's motion, will deter parties from filing such motions frivolously.

What happens if the panel determines that a party has filed a motion to dismiss in bad faith?
If a panel determines that a party filed a Rule 12504(a) or eligibility motion in bad faith, the panel may also issue sanctions against the party that filed the motion. Under the Codes, the panel may sanction a party for failure to comply with any provision in the Code, or any order of the panel or single arbitrator authorized to act on behalf of the panel. Such sanctions may include, but are not limited to: assessing monetary penalties payable to one or more parties; precluding a party from presenting evidence; making an adverse inference against a party; assessing postponement and/or forum fees; and assessing attorneys' fees, costs and expenses.

FINRA believes that the risk of monetary penalties and sanctions, imposed either by the panel on its own initiative, or as a result of a party's motion, will deter parties from filing a Rule 12504(a) motion in bad faith. Moreover, FINRA believes these enforcement mechanisms will help ensure strict compliance with the rules.

Do the rules prohibit a party from filing other motions to dismiss?
No. A party may file a Rule 12504(b) motion and such a motion will not be subject to the exceptions in Rule 12504(a). Thus, a moving party may file a Rule 12504(b) motion based on any applicable theory of law. FINRA expects these motions to be relevant to the case and based on theories that

are germane to the issues raised in the non-moving party's case. FINRA believes that by the close of the non-moving party's case, the panel will have heard enough evidence to decide whether a motion filed at this stage of the case should be considered and granted if warranted.

FINRA notes that if a party files a Rule 12504(b) motion, the panel is not required to consider or grant the motion. Arbitrators will continue to control the hearing process, which includes deciding whether to hear such a motion. Further, the rule will not preclude a panel from assessing parties who file these motions with sanctions, costs or attorney's fees, if the panel determines that a Rule 12504(b) motion filed at this time is frivolous or in bad faith.

In addition, a party may file a motion to dismiss based on Rules 12212 and 13212 (for material and intentional failure to comply with a panel order if prior warnings or sanctions have proven ineffective) or based on Rules 12511 and 13511 (for discovery abuse). Such motions will not be subject to the exceptions in Rule 12504(a), and will continue to be governed by their respective rules.

How does the eligibility rule differ from the provisions under the motion to dismiss rule?

Many of the changes under the eligibility rule are the same as those under the motion to dismiss rule, but there are some differences:

- First, the three exceptions to the motion to dismiss rule that prohibit arbitrators from acting on a motion to dismiss prior to the conclusion of a party's case, including a prehearing motion (i.e., (1) a signed settlement agreement and/or written release; (2) the contention that a moving party was not associated with the accounts, securities or conduct at issue; and (3) a claim regarding the same dispute against the same party that was fully and finally adjudicated on the merits and memorialized), will not apply to eligibility motions.
- Second, the filing deadlines for eligibility motions are different from those in the motion to dismiss rule. Under the eligibility rule, a party may file a motion to dismiss on eligibility grounds at any stage of the proceeding, except that a party may not file this motion any later than 90 days before the scheduled hearing on the merits, rather than the 60-day timeframe required under the motion to dismiss rule. The 90-day requirement also applies to eligibility motions that include multiple other grounds (i.e., a mixed motion). The 90-day requirement will encourage parties wishing to file an eligibility motion to determine in the early stages of the case whether to pursue their claims in court or to proceed with the arbitration. Further, the rule also provides parties with 30 days to respond to an eligibility motion, instead of the 45 days permitted under the motion to dismiss rule. The 30-day timeframe to respond to eligibility motions will expedite the process, so that the time between filing a claim and resolution of the dispute is shortened.
- Third, if a party files an eligibility motion that includes multiple other grounds, the panel must decide the eligibility issue first. If the panel grants a mixed motion on eligibility grounds, it must not rule on any other grounds for the motion. Further, if a party files a mixed motion, the party responding to the mixed motion will have 45 days to respond.

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12504. Motions to Dismiss

The Rule | Notices

(a) Motions to Dismiss Prior to Conclusion of Case in Chief

(1) Motions to dismiss a claim prior to the conclusion of a party's case in chief are discouraged in arbitration.

(2) Motions under this rule must be made in writing, and must be filed separately from the answer, and only after the answer is filed.

(3) Unless the parties agree or the panel determines otherwise, parties must serve motions under this rule at least 60 days before a scheduled hearing, and parties have 45 days to respond to the motion. Moving parties may reply to responses to motions. Any such reply must be made within 5 days of receipt of a response.

(4) Motions under this rule will be decided by the full panel.

(5) The panel may not grant a motion under this rule unless an in-person or telephonic prehearing conference on the motion is held or waived by the parties. Prehearing conferences to consider motions under this rule will be recorded as set forth in Rule 12606.

(6) The panel cannot act upon a motion to dismiss a party or claim under paragraph (a) of this rule, unless the panel determines that:

(A) the non-moving party previously released the claim(s) in dispute by a signed settlement agreement and/or written release;

(B) the moving party was not associated with the account(s), security(ies), or conduct at issue; or

(C) The non-moving party previously brought a claim regarding the same dispute against the same party that was fully and finally adjudicated on the merits and memorialized in an order, judgment, award, or decision.

(7) If the panel grants a motion under this rule (in whole or part), the decision must be unanimous, and must be accompanied by a written explanation.

(8) If the panel denies a motion under this rule, the moving party may not re-file the denied motion, unless specifically permitted by panel order.

(9) If the panel denies a motion under this rule, the panel must assess forum fees associated with hearings on the motion against the moving party.

(10) If the panel deems frivolous a motion filed under this rule, the panel must also award reasonable costs and attorneys' fees to any party that opposed the motion.

(11) The panel also may issue other sanctions under Rule 12212 if it determines that a party filed a motion under this rule in bad faith.

(b) Motions to Dismiss After Conclusion of Case in Chief

A motion to dismiss made after the conclusion of a party's case in chief is not subject to the procedures set forth in paragraph (a).

(c) Motions to Dismiss Based on Eligibility

A motion to dismiss based on eligibility filed under Rule 12206 will be governed by that rule.

(d) Motions to Dismiss Based on Failure to Comply with Code or Panel Order

A motion to dismiss based on failure to comply with any provision in the Code, or any order of the panel or single arbitrator filed under Rule 12212 will be governed by that rule.

(e) Motions to Dismiss Based on Discovery Abuse

A motion to dismiss based on discovery abuse filed under Rule 12511 will be governed by that rule.

Amended by SR-FINRA-2016-030 eff. Jan. 23, 2017.
Amended by SR-FINRA-2011-006 eff. June 6, 2011.
Amended by SR-FINRA-2009-026 eff. Apr. 17, 2009.
Adopted by SR-FINRA-2007-021 eff. Feb. 23, 2009.

Selected Notices: 09-07, 11-23, 17-02.

‹ 12503. MOTIONS UP 12505. COOPERATION OF PARTIES IN DISCOVERY ›

VERSIONS

Jan 23, 2017 onwards

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12206. Time Limits

The Rule | Notices

(a) Time Limitation on Submission of Claims

No claim shall be eligible for submission to arbitration under the Code where six years have elapsed from the occurrence or event giving rise to the claim. The panel will resolve any questions regarding the eligibility of a claim under this rule.

(b) Dismissal under Rule

Dismissal of a claim under this rule does not prohibit a party from pursuing the claim in court. By filing a motion to dismiss a claim under this rule, the moving party agrees that if the panel dismisses a claim under this rule, the non-moving party may withdraw any remaining related claims without prejudice and may pursue all of the claims in court.

(1) Motions under this rule must be made in writing, and must be filed separately from the answer, and only after the answer is filed.

(2) Unless the parties agree or the panel determines otherwise, parties must serve motions under this rule at least 90 days before a scheduled hearing, and parties have 30 days to respond to the motion. Moving parties may reply to responses to motions. Any such reply must be made within 5 days of receipt of a response.

(3) Motions under this rule will be decided by the full panel.

(4) The panel may not grant a motion under this rule unless an in-person or telephonic prehearing conference on the motion is held or waived by the parties. Prehearing conferences to consider motions under this rule will be recorded as set forth in Rule 12606.

(5) If the panel grants a motion under this rule (in whole or part), the decision must be unanimous, and must be accompanied by a written explanation.

(6) If the panel denies a motion under this rule, a party may not re-file the denied motion, unless specifically permitted by panel order.

(7) If the party moves to dismiss on multiple grounds including eligibility, the panel must decide eligibility first.

- If the panel grants the motion to dismiss the case on eligibility grounds on all claims, it shall not rule on any other grounds for the motion to dismiss.
- If the panel grants the motion to dismiss on eligibility grounds on some, but not all claims, and the party against whom the motion was granted elects to move the case to court, the panel shall not rule on any other ground for dismissal for 15 days from the date of service of the panel's decision to grant the motion to dismiss on eligibility grounds.
- If a panel dismisses any claim on eligibility grounds, the panel must record the dismissal on eligibility grounds on the face of its order and any subsequent award the panel may issue.
- If the panel denies the motion to dismiss on eligibility grounds, it shall rule on the other bases for the motion to dismiss the remaining claims in accordance with the procedures set forth in Rule 12504(a).

(8) If the panel denies a motion under this rule, the panel must assess forum fees associated with hearings on the motion against the moving party.

(9) If the panel deems frivolous a motion filed under this rule, the panel must also award reasonable costs and attorneys' fees to any party that opposed the motion.

(10) The panel also may issue other sanctions under Rule 12212 if it determines that a party filed a motion under this rule in bad faith.

(c) Effect of Rule on Time Limits for Filing Claim in Court

The rule does not extend applicable statutes of limitations; nor shall the six-year time limit on the submission of claims apply to any claim that is directed to arbitration by a court of competent jurisdiction upon request of a member or associated person. However, when a claimant files a statement of claim in arbitration, any time limits for the filing of the claim in court will be tolled while FINRA retains jurisdiction of the claim.

(d) Effect of Filing a Claim in Court on Time Limits for Filing in Arbitration

If a party submits a claim to a court of competent jurisdiction, the six-year time limitation will not run while the court retains jurisdiction of the claim matter.

Amended by SR-FINRA-2011-006 eff. June 6, 2011.
Amended by SR-FINRA-2009-013 eff. Aug. 10, 2009.
Amended by SR-FINRA-2007-021 eff. Feb. 23, 2009.
Amended by SR-FINRA-2008-021 eff. Dec. 15, 2008.
Amended by SR-NASD-2007-026 eff. April 16, 2007.
Adopted by SR-NASD-2003-158 eff. April 16, 2007.

Selected Notices: 07-07, 08-57, 09-07, 09-36, 11-23.

‹ 12205. SHAREHOLDER DERIVATIVE ACTIONS UP 12207. EXTENSION OF DEADLINES ›

VERSIONS

Jun 06, 2011 onwards

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Regulatory Notice 17-02

SEC Approves Amendments to the Codes of Arbitration Procedure Regarding Motions to Dismiss

Effective Date: January 23, 2017

Motions to Dismiss in Arbitration

Regulatory Notice	
Notice Type Rule Amendment	**Referenced Rules & Notices** FINRA Rule 12504 FINRA Rule 13504
Suggested Routing Compliance Legal Registered Representatives Senior Management	**Key Topics** Arbitration Codes of Arbitration Procedure Motions to Dismiss

NOTICE SUGGESTED ROUTING

Compliance

Legal

Registered Representatives

Senior Management

NOTICE KEY TOPICS

Arbitration

Codes of Arbitration Procedure

Motions to Dismiss

Summary

The Securities and Exchange Commission (SEC) approved[1] amendments to FINRA Rules 12504 and 13504 (Motions to Dismiss) of the Customer and Industry Codes of Arbitration Procedure (Codes) to add an additional ground for arbitrators to act on motions to dismiss prior to the conclusion of the claimant's case in chief. The new ground provides that arbitrators may act upon a motion to dismiss a party or claim prior to the conclusion of a party's case in chief if the arbitrators determine that the non-moving party previously brought a claim regarding the same dispute against the same party, and the dispute was fully and finally adjudicated on the merits and memorialized in an order, judgment, award or decision.

The amendments are effective for motions to dismiss filed on or after January 23, 2017.

The text of the amendments is set forth in Attachment A.

Questions concerning this *Notice* should be directed to:

- David Carey, Associate Director, FINRA Office of Dispute Resolution, at (212) 858-4333 or *david.carey@finra.org*; or
- Margo Hassan, Associate Chief Counsel, FINRA Office of Dispute Resolution, at (212) 858-4481 or *margo.hassan@finra.org*.

Background & Discussion

FINRA Rules 12504 and 13504 specify procedures that limit the use of motions to dismiss in arbitration. Under the Codes, arbitrators cannot act upon a motion to dismiss prior to the conclusion of the non-moving party's case in chief unless the arbitrators determine that: (1) the non-moving party previously released the claim in dispute by a signed settlement or written release,[2] (2) the moving party was not associated with the account, security or conduct at issue,[3] or (3) a claim is not eligible for arbitration because it does not meet the six-year time limit for submitting a claim.[4] In addition, parties must file prehearing motions to dismiss in writing, separately from the answer, and only after they file the answer. The full panel of arbitrators must

decide a motion to dismiss, and the panel must hold a hearing on the motion unless the parties waive the hearing. If a panel grants a motion to dismiss, the decision must be unanimous, and must be accompanied by a written explanation.

FINRA has amended the Codes to add an additional ground for arbitrators to act on motions to dismiss prior to the conclusion of the claimant's case in chief. The new ground provides that arbitrators can also act upon a motion to dismiss a party or claim if they determine that the non-moving party previously brought a claim regarding the same dispute[5] against the same party that was fully and finally adjudicated on the merits and memorialized in an order, judgment, award or decision.

The amendments allow arbitrators to grant a motion to dismiss relating to a particular controversy if they believe the matter was adjudicated fully even in instances where a claimant adds a new cause of action or adds additional facts. In order for the arbitrators to grant the motion, the moving party must demonstrate that the non-moving party brought the same dispute against the same party and that the non-moving party had a full opportunity to present its claims in the earlier proceeding.

Effective Date

The amendments are effective for motions to dismiss filed on or after January 23, 2017.

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1. *See* Securities Exchange Act Release No. 79285 (November 10, 2016), 81 FR 81213 (November 17, 2016) (Order Approving File No. SR-FINRA-2016-030).

2. *See* FINRA Rules 12504(a)(6)(A) and 13504(a)(6)(A).

3. *See* FINRA Rules 12504(a)(6)(B) and 13504(a)(6)(B).

4. *See* FINRA Rules 12206 and 13206 (Time Limits), which provide that no claim shall be eligible for submission to arbitration where six years have elapsed from the occurrence or event giving rise to the claim.

5. FINRA Rules 12100 and 13100 providethat "dispute" means a dispute, claim or controversy, and that it may consist of one or more claims.

Attachment A

Customer Code

12504. Motions to Dismiss

(a) Motions to Dismiss Prior to Conclusion of Case in Chief

(1) Motions to dismiss a claim prior to the conclusion of a party's case in chief are discouraged in arbitration.

(2) Motions under this rule must be made in writing, and must be filed separately from the answer, and only after the answer is filed.

(3) Unless the parties agree or the panel determines otherwise, parties must serve motions under this rule at least 60 days before a scheduled hearing, and parties have 45 days to respond to the motion. Moving parties may reply to responses to motions. Any such reply must be made within 5 days of receipt of a response.

(4) Motions under this rule will be decided by the full panel.

(5) The panel may not grant a motion under this rule unless an in-person or telephonic prehearing conference on the motion is held or waived by the parties. Prehearing conferences to consider motions under this rule will be recorded as set forth in Rule 12606.

(6) The panel cannot act upon a motion to dismiss a party or claim under paragraph (a) of this rule, unless the panel determines that:

(A) the non-moving party previously released the claim(s) in dispute by a signed settlement agreement and/or written release; [or]

(B) the moving party was not associated with the account(s), security(ies), or conduct at issue; or[.]

(C) The non-moving party previously brought a claim regarding the same dispute against the same party that was fully and finally adjudicated on the merits and memorialized in an order, judgment, award, or decision.

(7) If the panel grants a motion under this rule (in whole or part), the decision must be unanimous, and must be accompanied by a written explanation.

(8) If the panel denies a motion under this rule, the moving party may not re-file the denied motion, unless specifically permitted by panel order.

(9) If the panel denies a motion under this rule, the panel must assess forum fees associated with hearings on the motion against the moving party.

(10) If the panel deems frivolous a motion filed under this rule, the panel must also award reasonable costs and attorneys' fees to any party that opposed the motion.

(11) The panel also may issue other sanctions under Rule 12212 if it determines that a party filed a motion under this rule in bad faith.

(b)–(e) No change.

Industry Code

13504. Motions to Dismiss

(a) Motions to Dismiss Prior to Conclusion of Case in Chief

(1) Motions to dismiss a claim prior to the conclusion of a party's case in chief are discouraged in arbitration.

(2) Motions under this rule must be made in writing, and must be filed separately from the answer, and only after the answer is filed.

(3) Unless the parties agree or the panel determines otherwise, parties must serve motions under this rule at least 60 days before a scheduled hearing, and parties have 45 days to respond to the motion. Moving parties may reply to responses to motions. Any such reply must be made within 5 days of receipt of a response.

(4) Motions under this rule will be decided by the full panel.

(5) The panel may not grant a motion under this rule unless an in-person or telephonic prehearing conference on the motion is held or waived by the parties. Prehearing conferences to consider motions under this rule will be recorded as set forth in Rule 13606.

(6) The panel cannot act upon a motion to dismiss a party or claim under paragraph (a) of this rule, unless the panel determines that:

(A) the non-moving party previously released the claim(s) in dispute by a signed settlement agreement and/or written release; [or]

(B) the moving party was not associated with the account(s), security(ies), or conduct at issue; or[.]

(C) The non-moving party previously brought a claim regarding the same dispute against the same party that was fully and finally adjudicated on the merits and memorialized in an order, judgment, award, or decision.

(7) If the panel grants a motion under this rule (in whole or part), the decision must be unanimous, and must be accompanied by a written explanation.

(8) If the panel denies a motion under this rule, the moving party may not re-file the denied motion, unless specifically permitted by panel order.

(9) If the panel denies a motion under this rule, the panel must assess forum fees associated with hearings on the motion against the moving party.

(10) If the panel deems frivolous a motion filed under this rule, the panel must also award reasonable costs and attorneys' fees to any party that opposed the motion.

(11) The panel also may issue other sanctions under Rule 13212 if it determines that a party filed a motion under this rule in bad faith.

(b)–(e) No change.

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Hypothetically Speaking, an Introduction to Well-Managed Account Analysis

John Fazio
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Introduction

One or both parties in an arbitration may offer hypothetical calculations. Respondents typically argue that only "actual losses" are compensable and that "what if" calculations are impermissibly speculative. This article takes no position on this legal issue, and attorneys on either side of the bar will brief it as they will. Attorneys on both sides may find this article useful if they are unfamiliar with such calculations.

For equity accounts, the S&P 500 Index is considered to be a surrogate for the large cap segment of the overall market, and is generally used as the benchmark to make the performance comparison.

For fixed income accounts, the Lehman Brothers Aggregate Bond Index is generally used. While there haven't been many arbitrations involving bonds or "junk bonds" recently, the Lehman Bond Index has been widely used in matters alleging that the account at issue should never have invested in stocks, but should have invested in bonds.

Of course, there are many other indexes as well as mutual funds that can be utilized as models for well-managed account analysis, but using them requires additional justification.

An idealist may tell you that the performance of the securities account at issue should match the performance of a given market index. If the securities account under performs a given market index, damages are alleged. If the performance of the securities account matches or exceeds a

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given index, there are no “damages”. According to the idealist, these tenets hold up even if the securities account may have suffered an actual loss.

This may sound good, but the outcomes of all arbitrations depend on the allegations and facts to be proven, the law, including the law of damages, and what the arbitration panel believes.

While well-managed account analysis doesn’t prove or disprove liability or damages, it can be used as a reference point for comparing how the account(s) at issue performed against the market. The analysis is presented at arbitration hearings to educate and influence arbitrators.

When I worked for the New York Stock Exchange, some of the older, more experienced examiners that I met had an adage that they liked to repeat to the younger ones. They liked to say “numbers tell a story.” Let’s take a quick look at how the numbers work.

Two simple examples appear below. At the very outset it should be noted that like many things on Wall Street, the well-managed account analysis is steeped in irony: bear markets, which should be bad for Wall Street, favor respondents, and bull markets which should be good for Wall Street, favor claimants.

Bear Market Example: The actual account lost $150; the market was down $100; the market-adjusted loss is $50.

Bull Market Example: The actual account lost $150; the market was up $100; the market-adjusted loss is $250.

As can be seen, down markets generally favor respondents, and up markets generally favor claimants (leaving aside the fact that respondents are far more likely to get sued when the markets decline). Of course, the allegations in the claim must be proven to the panel in order to

receive an award. The production and presentation of even the best-crafted well-managed analysis is not a *heat-seeking missil*e for the claimant or an *ace in the hole* for the respondent.

Basic Analyses for Arbitrations

Preparing an accurate gain-loss analysis is the first step in the process of preparing the well-managed account analysis. The gain-loss analysis tells us how the account or accounts at issue actually performed on an overall basis. If you're familiar with the basics, please skip this section.

The main components of the basic formulas for the most common gain-loss calculations used in arbitration are summarized below:

Net-out-of-pocket Calculation:

Cash and securities deposited, less cash and securities withdrawn and closing equity equals the gain-loss.

Detailed or "trade for trade" Calculation:

The cost of securities purchased plus the value of securities deposited less sales proceeds and the value of securities held and withdrawn, adjusted for dividends and interest earned and fees paid equals the gain-loss.

Overall performance includes realized and unrealized capital gains and losses, income earned, margin interest expense, and fees charged. Collectively these components are commonly referred to as "total return".

If the formulas are followed faithfully, the "bottom line" results for each calculation will be exactly the same.

Preparing an accurate gain-loss analysis helps the expert avoid the most common error in preparing a well-managed account analysis -- not identifying all the entries that will be needed. The entries made in the well-managed account analysis are the base of the calculation. If those entries are wrong, or incomplete the hypothetical will not withstand the scrutiny of cross-examination.

Of course, due diligence doesn't always assure immunity from errors. Even in the age of micrographic and electronic storage media, some monthly statements and documents may not be found, which will cause flaws in the analysis.

What are the account objectives? risk tolerance?

The next step is identifying what the true investment objectives and risk tolerance of the claimant were. The respondent will generally argue that the information set forth on the new account form should be relied upon; the claimant will argue that the information shown on the form is inaccurate, out of date, or that the claimant misunderstood the form.

The expert must use his best judgment after reviewing the Statement of Claim, Statement of Answer and facts available to him. In some matters, the investment experience of the claimant may point the way. In a recent matter, an 85-year-old man filed a suit complaining that he suffered losses after 1999 in an equity account managed by a third party advisor. One party argued that equities were suitable for an 85-year-old man if he chose to purchase them; the other party argued that equities were unsuitable for the customer based on his age.

The panel ruled for the respondent after evidence was presented showing that the same customer had invested in equity based mutual funds for several years at another firm after he closed the managed account. Had the customer invested in fixed income securities, the panel might have concluded that the client, having been burned in the stock market, changed his objective because he then wanted the relative stability of fixed income products, or the panel could have

determined that equities were unsuitable for him. In this particular matter, the investments made by the customer after he closed his account corroborated the broker's story. The panel found the proof was in the pudding. Most matters are rarely this simple.

Investments made by customers before and during the period of the account at issue may also be dispositive one way or another. But in many cases, the determination of investment objectives and risk tolerance will hinge on the testimony of the primary witnesses.

What is an appropriate index?

The expert will attempt to match up an index with the customer's investment objectives and risk tolerance and explain how he reached that decision. This can be fraught with problems.

If the account objectives typically found on brokerage account forms (growth, current income, tax deferral, liquidity) were placed end to end and risk tolerance was listed below each of them (conservative, moderate, aggressive) one would see that there is more than one legitimate way to satisfy a given objective. Of course, some ways will perform better than others.

Recognizing this, the expert might present a range of possible alternatives rather than hold up single model. The alternatives should be carefully selected based on the facts in the case; the expert should be wary of presenting too many alternatives as this may send the wrong signal to the panel.

Average Returns

The S&P 500 is often held up as the measure of average return for equity portfolios. Stanley Meyerson, one of the pre-eminent experts in the field today says, "An argument can be made that the S&P 500 Index (Wilshire 5000 and other total market indexes) should only be used by investors seeking a market rate of return; it cannot be used by investors seeking above market returns."

As a side note, some money managers get paid a bonus for beating the S&P 500. Returns above the Index could be due greater exposure to risk, superior performance and avoidance of certain industries. The main reason why money managers lose their position is underperformance.

Blue Chips

In a recent matter, a customer claimed that he only wanted "blue chip" securities in his account; he claimed he had lost money because the stocks in his account weren't blue chips. Blue chips are widely viewed to be high quality investments involving a lower-than-average risk of loss compared to other equities. Ironically, the term "blue chip" itself originates from poker, a game of chance.

An analytical question became obvious: How did the account at issue perform compared to a "blue chip" portfolio? After searching the Internet, more than 20 mutual funds were found that promoted themselves as having blue chip portfolios.

Each of the "blue chip" mutual funds was subject to active management by an experienced group of professionals. The mutual fund returns varied considerably, some performed better than the account at issue, some worse. The panel was shown the results for all the "blue chip" funds, not just those that performed poorly.

There is a bountiful supply of indexes, mutual funds and exchange-traded funds to hold up as a model for comparison. There are custom indexes and branded indexes. In 1976, indexes figuratively came to life for retail investors in the form of mutual funds and were later reincarnated in 1993 in the form of exchange-traded funds.

Recently some indexes have been structured for hedge funds. Some of the indexes are equal-weighted averages of hedge funds grouped by strategy. Hedge funds don't possess the

accoutrements of the securities traded in the stock market. They are organized as non-regulated limited partnerships; because some of their investments are not publicly traded and reporting is not uniform, returns and valuations are not up to date. Prices are not reported from moment to moment as they are in the stock market. Using stock market benchmarks for performance comparisons for hedge funds may not be appropriate.

Questions may arise when an expert chooses an esoteric index and not the bellwether index.

In general, experts should make it their practice to rely on the most reputable sources of information. For reporting changes to the consumer price index, is there a more reputable source than the U.S. Bureau of Labor Statistics? For reporting changes to the interest rates, is there a more reputable source than the Federal Reserve?

What's in the index? In the model portfolio?

When an expert selects an index or mutual fund for modeling, he needs to know what's in the index. When he testifies, the expert will need to describe what's in the index to the panel.

I started asking myself the question, "What's in the index?" many years ago after working on a matter involving preferred stocks. The account at issue had some 30-40 different preferred stocks in it. I came across an index for preferred stocks, but the index had only two stocks in it. It was necessary to look for another index to serve as a benchmark.

S&P 500

The S&P 500 is a value-weighted "blend" of large cap growth and value stocks. The Index covers about 70% of total market capitalization. The remaining 30% of the market is represented by stocks in the Wilshire 4500.

As of June 30, 2006 the stocks in the S&P 500 Index had a median market capitalization of $48.6 billion, an average price/earnings ratio of 16.7x, an average price/book ratio of 2.7x and an average yield of 1.9%. By convention the S&P 500 has a Beta of 1.00.

The development of the S&P 500 Index can be traced back to 1923. The Index has been altered several times. In 1957 the Index was expanded to 500 stocks. In 2002 non-U.S. companies were removed from the Index. In 2004 the Index made the "evolutionary" transition to the current float-adjusted version.

Standard & Poor's follows a set of published guidelines for maintaining the S&P 500 Index, which includes criteria for index additions and criteria for index removals. The criteria for additions are the location of the company's operations, its market capitalization, financial viability, liquidity, price, public "float", and sector representation. In addition, only operating companies are considered for inclusion.

Real People, Real Money

Conventional thinking has always been that the S&P 500 is an "unmanaged" Index. Here's a FAQ: How can an unmanaged index be the standard for the well-managed equity account? This question may assume facts not in evidence. The question assumes that the Index is not managed through a process involving economic, financial or market analysis.

If Copernicus, an unconventional thinker, were alive today and watched the stock market, he might suggest that the Index is managed by a consensus of investors. Copernicus might liken the inner workings of the Index to a democracy. The analogy is that investors vote with their dollars when they buy and sell stocks. For the most part, investors consider all factors they deem relevant before making a transaction. In the analogy, the vote count determines which stocks will make it into the Index and how much clout they will have inside the Index; S&P merely provides the voting booth for investors.

The empirical proof that the Index is managed by investors is reflected in the play by play reported in the annual and semi annual shareholder reports filed by Index funds. These reports chronicle the factors underlying investor decisions and behavior that move and shape the state of the market.

The portfolio characteristics of the Index are not static and change as the result of changes to stock prices. The following table shows the characteristics at various dates.

S&P 500 Characteristics

	6/2000	6/2002	6/2004
Closing Price	1,454.60	989.82	1,140.84
Median Market Cap	$94.9B	$45.2B	$51.7B
Price/Earnings Ratio	28.7x	25.6x	20.6x
Price/Book Ratio	5.2x	3.2x	3.0x
Div Yield	1.15%	1.62%	1.63%

Source: Median market cap as calculated by Vanguard Index Funds

Market driven changes to S&P 500 industry sectors can be seen in the following table. Some Index mutual funds, whose performance closely matches the Index, classify industry constituents much differently than Standard & Poor's. Accordingly, changes to sector breakdown may take on a different focus Index fund to Index fund.

S&P 500 Sector Breakdown by Market Cap

	2000	2002	2004
Consumer Discretionary	10.28%	13.44%	11.90%
Consumer Staples	8.10%	9.47%	10.48%
Energy	6.57%	6.00%	7.16%
Financials	17.34%	20.45%	20.64%
Health Care	14.36%	14.91%	12.68%
Industrials	10.57%	11.53%	11.79%
Information Technology	21.23%	14.31%	16.05%
Materials	2.30%	2.83%	3.09%
Telecommunication Ser	5.46%	4.19%	3.27%
Utilities	3.79%	2.85%	2.94%

Source: Standard & Poor's

Lehman Brothers Bond Indexes

The Lehman Brothers Aggregate Bond Index had 6,824 publicly traded bond issues in it as of June 30, 2006. The Index had a 5.8% yield to maturity, 5.3% average coupon, average effective maturity of 7.2 years, average duration of 4.8 years and average quality of Aa1 (Moody's).

The Lehman Brothers Aggregate Bond Index consists of bonds of the following description: Treasury/Agency (26%), Government Mortgage-Backed (35%), Industrial (9%), Finance (9%), Commercial Mortgage-Backed (6%) and Utilities (2%).

Lehman also publishes indexes for municipal bonds, GNMAs, high yield bonds, credit bonds, short-term bonds, intermediate and long-term bonds.

When are index entries to be made in the calculation?

Well-managed account analysis can be constructed in several different ways:

1. The dollar amount of cash and securities deposited and withdrawn from the actual account is reflected as of the date of the deposit or withdrawal; or

2. The dollar amount of cash and securities deposited and withdrawn are "netted" into a single dollar entry made at month-end; or

3. The dollar amount of purchases and sales in the account are entered (instead of deposits and withdrawals) as of the same dates on which trades were made in the account at issue.

Using the last method, which I'll refer to as the "trade date" method, is probably the most accurate method, but it is probably the one that is used the least. The price for the trade date method is many hours behind the computer. The single "netted" monthly entry is probably the most common method used to prepare the analysis presented in securities arbitrations.

There are many good software products that can be utilized to make the calculations for you after you have determined what the dollar amounts of the entries should be. The benefit of using these products is that they come from a reputable third party, which has no interest in the outcome of the arbitration.

The following is an example of an index calculation prepared using the so-called trade date method. In the example, $100,000 was placed in General Electric stock in 2002. The stock was sold later the same year. The price of the shares liquidated on the sale date determines gain-loss.

Actual Account

Trade Dt	Entry	Shares	Price	$ Amount
01/04/02	buy	605	$41.36	($25,023)
01/11/02	buy	647	38.61	(24,981)
01/18/02	buy	640	39.06	(24,998)
01/25/02	buy	647	38.64	(25,000)
02/27/02	div			457
06/26/02	div			457
09/25/02	div			457
12/02/02	sell	-605	26.93	16,293
12/06/02	sell	-647	25.79	16,686
12/13/02	sell	-640	25.25	16,160
12/20/02	sell	-647	25.69	16,621
Gn/(Loss)				($32,871)

S&P 500 Hypo

Trade Dt	Entry	Shares	Price	$ Amount
01/04/02	buy	21.3	$1,172.51	($25,000)
01/11/02	buy	21.8	1,145.60	(25,000)
01/18/02	buy	22.2	1,127.58	(25,000)
01/25/02	buy	22.1	1,133.28	(25,000)
03/22/02	div			275
06/21/02	div			284
09/27/02	div			331
12/02/02	sell	-21.3	934.53	19,926
12/06/02	sell	-21.8	912.23	19,907
12/13/02	sell	-22.2	889.48	19,721
12/20/02	sell	-22.1	895.76	19,760
Gn/(Loss)				($19,796)
Mkt Adj Loss				($13,075)

The well-managed account comparison shows that GE lost $32,871 and the S&P 500 lost $19,796. Accordingly, the market adjusted loss for this example is $13,075.

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For the preceding example, which was a very simple one, the Index loss and market adjusted loss would be $20,920 and $11,951, respectively, using the more error prone single netted monthly entry method to make the calculation. In more complex matters, the error factor may be greater. Conceptually, the error factor would be greatest during months of high volatility, such as July 2002 when the S&P 500 Index fluctuated 218.78 points intra-month from peak to trough.

Most software vendors use the single netted monthly entry as protocol. Accordingly, this is not a perfect solution, but presenting a report prepared with vendor software will be accepted at most hearings, provided there aren't major market movements between the actual investment date and month-end.

If a hypothetical were constructed based on the price of the S&P 500, only a portion of the Index's performance would be captured. In 2005 for example, the S&P 500 returned 3.00% based on its closing price. But if dividends paid by the stocks in the Index were reinvested during the year, the S&P 500 would have returned 4.89%. The same concept also applies to mutual funds. Prices alone cannot be used to reflect performance. Dividends must be accounted for.

One of the most prevalent errors found in the well-managed account analysis using the single netted monthly entry is that cash and security withdrawals are not properly accounted for.

Sometimes the entries are simply omitted. Sometimes the dollar amounts used are inaccurate. Sometimes average monthly withdrawals are used, instead of the actual dollar amounts, and if that weren't bad enough, sometimes the dollar averages used are inaccurate. The impact on the hypothetical calculation can be significant.

Another error commonly made by experts is that they show how the actual account performed and how the index performed. However, they don't supply the panel with the "market adjusted

loss". As summarized on page four, sometimes the results of the index hypothetical are added to the actual loss, and sometimes the results of the index hypothetical are subtracted. When the panel goes into deliberation, you don't want the panelists to guess how to make the adjustment.

Should hypotheticals be prepared for less than the full period of the account?

Arbitration panels may not like this because it may look like someone is trying to hide something. If there is a strong reason for doing this, the expert may consider showing the calculation for the full period on one schedule and the calculation for the truncated period on another.

How is margin accounted for?

Using the single netted monthly entry as the basis for the leveraged hypothetical will not work because it will not capture the leverage used in the actual account.

Using the trade date method (purchases and sales) instead may come closer to reflecting the leverage used in the actual account, but additional adjustments for other items may be necessary.

A similar problem occurs when the account at issue has a sizable cash balance. Cash is an investment on which interest is earned, but cash and cash equivalents are insulated from the stock market. All things being equal, in a bull market an account with cash will under perform an account that is fully invested; in a bear market, the account with cash will outperform an account that is fully invested.

If the cash balance in the account at issue is sizable, using the trade date method (purchases and sales) may be a more accurate way of making an index comparison than a calculation based on single netted monthly entry.

Misleading Advertising

Just before the 1987 crash, an option-income fund was organized. The mutual fund had collected money from investors, but had not made many investments. When the crash took place, the new fund didn't take any loses, it was awash with cash and cash equivalents. A well-known rating agency held the new fund as number one in its category. The option-income fund then used that rating to promote itself and solicit new investors, but didn't bother to explain the circumstances surrounding the rating.

How are changes to portfolio composition handled?

In most retail brokerage arbitrations, if a well-managed account analysis is prepared, the comparison will usually be based on a single index or mutual fund used from start to finish. In some matters, you may see an equity index and fixed income index side by side. Sometimes a "blended" index is used.

If the account at issue changed its portfolio composition significantly during the period that it was open, the change may need to be reflected in the index models selected for comparison purposes. It may become necessary to use one index up to a certain point, and then use a different index thereafter. Large and abrupt portfolio changes are easier to handle in the well-managed account analysis constructed from single netted monthly entries than subtle portfolio changes that take place over long periods of time.

Portfolio changes are captured more accurately using the trade date method. The expert will sort the purchases and sales by securities type and chose an index for each security type. The hypothetical calculations will be made separately for each security type then combined in a single spreadsheet. Sorting the purchases and sales by securities type makes it is possible to "lift out" one section of the portfolio in a diverse account. A "stand alone" analysis can then be prepared for that section.

A party may argue that a change to the portfolio should have been made and present a well-managed account analysis showing what would have happened if the change had been made.

For example, a customer may argue that the account should have moved out of stocks and into fixed income at some point. The broker may argue that he advised the customer to change the portfolio, but the customer didn't listen. Without a strong supporting set of facts, the well-managed account analysis prepared to demonstrate what would have occurred, may appear to be speculative.

How are securities deposited handled? securities delivered?

These are interesting questions. The answers depend on the unique facts and issues in the particular case. Unless there's an appropriate reason to the contrary, experts will generally want to separate the performance of the securities acquired in the account at issue from the securities deposited by the customer. This applies to both the basic gain-loss analysis and well-managed account analysis.

Securities deposited into an account fall into three categories:

1. Securities deposited into an account and sold within a relatively short period of time -- probably the fairest way to make the calculation is to reflect the securities at their sales proceeds as of the date of sale;

2. Securities deposited into the account and held or transferred out before they are sold -- these should probably be backed out; and

3. Concentrated positions deposited into the account -- barring a very strong reason to the contrary, concentrated positions deposited into the account at issue should be backed out.

The argument on the last two categories above is that the client acquired the securities elsewhere, and then elected to transfer them to the subject account and hold them; this makes them unsuited for an analysis that assumes the positions should have been sold and reinvested in an index.

Experts also need to consider how to handle positions purchased in the account at issue that are delivered out. Specifically, a determination needs to be made to either "mark" those securities to the market as of the delivery date, or track them through to their ultimate sale.

What is the "undisturbed portfolio"?

This is a calculation that is sometimes presented by the parties instead of, or in addition to, an index hypothetical. The securities in the customer's original portfolio will be rolled forward to some future date and re-priced, then compared to the value of the account at issue.

The claimant's version of this calculation is based on the theory that the customer's original portfolio was appropriate, and the portfolio that the broker recommended was inappropriate. It is an effort to show the panel that the customer would have avoided the loss or would have been better off if he had simply kept his original portfolio and never met his new broker.

There may be some problems in these calculations. The calculations may ignore the fact that the customer's original portfolio had "turnover". They may also ignore the fact that the customer sold the old portfolio for a reason and that the new portfolio wasn't the unilateral decision of the broker. If the customer was withdrawing funds from his account, the expert will be faced with the problem of deciding which securities would have been sold to fund the withdrawals.

Respondents sometimes employ a different version of this same calculation. The objective is to show that the investments at issue would have recouped some or all of their loss if the

investments were held. The respondent will be faced with some of the same problems as the claimant who prepares the undisturbed portfolio.

In recent history, 2003 was an excellent year for the respondent to run this "if held" calculation. The S&P 500 Index returned 28.7% in 2003. Other indexes also turned around in 2003. One thing is certain about "if held" calculations and that is: you won't see many calculations run for 2001 or 2002 when the market was down.

Sometimes the parties will reverse tactics and present the analysis usually presented by the opposing party. The respondent will prepare the undisturbed portfolio analysis to show that holding the original portfolio would have resulted in deeper losses. The claimant will prepare the "what if" analysis to show that if the new portfolio were held it would have resulted in deeper losses.

What do we do after the analysis has been prepared?

My high school chemistry teacher was famous for saying "the one-eyed man is king of the blind." After the hypothetical calculation is prepared, additional work must be done to help the panel understand what happened. This is actually the interesting part, or as my Driver's Ed teacher would say, "forget what the chemistry teacher said, you need to keep both eyes on the road."

Let's assume that a growth mutual fund lost money against a particular index. This has been known to happen. The question should then become, how did the mutual fund perform against its peer group? Was the mutual fund at the top of its peer class, the bottom of its peer class or somewhere in between? Morningstar and similar services provide data that may be useful in "sizing up" where the mutual fund stood performance-wise.

A mutual fund that performed below its peer group average may not necessarily be cause for liability; often there are innocent reasons for underperformance. The performance of the mutual fund or the track record of its managers before the investment was made should all be considered.

What the mutual fund did the year before the investment was made, and what happened the year before that, and what happened the year before that needs to be considered. Arbitration panels understand that track record is an important part of the basis for making any investment decision. This information needs to be given to them.

Manager of the Year

Several years ago, Jeff Vinik, the fellow who replaced Peter Lynch at the helm of Fidelity Magellan, won Morningstar's prestigious Manager of the Year award. The Fidelity fund beat the S&P 500 by 14 points in 1993. Sometime later, Vinik lost his position at Fidelity. He made decisions that didn't pan out. Between September 1995 and July 1996, the Fidelity fund lost 3.4%, while the S&P 500 returned 11.6%.

Would it have been wrong to make an investment in the Fidelity fund in September 1995? No, the loss was unforeseeable and the fund's earlier returns provided a reasonable basis for making the investment.

In securities arbitrations, poor performance does not imply fraud or a breach of duty. Even poor results should not be held against brokers or investment managers if they can show the panel that they had good, non-fraudulent reasons for making their decision at the time it was made.

Historic returns are available or can be calculated for individual stocks, mutual funds, and managed accounts. However, contemporaneous reports, or "fact sheets", as they are sometimes

called, containing opinions from Morningstar, Lipper, Value Line and other services are usually discarded to make room for current reports. The old reports may be worth their weight in gold if they can be found.

The Oracle of Omaha

One of America's most successful companies, Berkshire Hathaway, has a sizable investment portfolio. Buried in a footnote near the back of its annual report are a few words of caution for investors to memorize: "*The amount of investment and derivative gains and losses for any given period has no predictive value and variations in amount from period to period has no practical analytical value."*

The footnote is transferable, so while track record is a strong reason for selecting an investment, it is not a guarantee that the investment will be successful.

Conservative Investors

Conservative investors are not immune from the gyrations of the stock market. The Pension Benefit Guaranty Corporation was established as a federal corporation in 1974 to protect the pensions of millions of workers in private defined benefit pension plans. The PBGC operates under the "guidance" of its Board of Directors: The U.S. Secretaries of Labor, Commerce and Treasury.

When the market went haywire in 2001 and 2002, the PBGC took market losses like other investors on its investments in equity securities. It also took losses on its AAA fixed income portfolio in 1999.

In its annual report the PBGC compares the results of its equity investments in its Trust Funds to the S&P 500 and Wilshire 5000. As of September 2005, the average price/earnings ratio was 20.2x, the dividend yield was 1.6% and the Beta was 1.03.

The results of PBGC's fixed income investments in its Revolving Funds are compared to the Lehman Brothers Long Treasury Index. As of September 2005, the average quality was AAA, the average maturity was 16.6 years, the average duration was 10.4 years and the yield to maturity was 4.8%.

The PBGC's annual report states that PBGC "uses institutional investment management firms to invest its assets subject to PBGC oversight". The latter part of this quotation exemplifies the checks and balances that exist in relationships involving customers and their brokers or advisors.

Institutional Ownership

When specific stocks are at issue, the expert may want to turn to historic SEC filings, specifically the section of the annual proxy statements for those companies indicating institutional ownership.

In addition, institutional investment managers who exercise investment discretion over $100 million or more in equity securities must report their holdings on Form 13F with the SEC. Those reports can be viewed on EDGAR, the SEC website.

An institutional investment manager is a person or an entity that exercises investment discretion over the account of any other person or entity and can include investment advisers, banks, insurance companies, and pension funds.

For conservative equity investors, a significant level of institutional ownership in a given security may be helpful in establishing the reasonableness of a recommendation, because it shows that significant investment managers as a community thought that the stock was a worthwhile investment. This assumes the institutions holding the particular stock serve

conservative equity investors. Institutional ownership is the corollary to the theory that the model held up for comparison in the well-managed account analysis is a suitable investment.

Summary & Conclusion

This chapter is only an introduction to the subject: Within the scope of an introduction, it is not possible to cover every aspect of the subject. The main points are as follows:

The well-managed account analysis doesn't prove or disprove liability; while frequently introduced in securities arbitrations, its relevance is frequently questioned.

Depending on the care taken, well-managed account analyses and index hypotheticals may prove to be more of a rough approximation of how the account performed against the market than science. The most accurate method used to make these calculations is the so called "trade date" method (but it doesn't capture intra-day market volatility).

It is incumbent upon the expert to describe how the well- managed account analysis was prepared, disclose the assumptions made behind the numbers, and most importantly, place the results into perspective because the numbers tell a story, but not the whole story.

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Financial Industry Regulatory Authority

FINRA Dispute Resolution Services Arbitrator's Guide



This Guide contains important information about FINRA Dispute Resolution Services' forum, policies and procedures. For additional information, please go to our website: www.finra.org or call one of our regional offices.

FINRA Dispute Resolution Services attempts to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding concerning a rule in the Customer or Industry Code of Arbitration Procedure, the rule language prevails.

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Explained Decisions

FINRA Rule 12904 provides that the parties may **require** the arbitrators to write an explained decision. If the parties submit a joint request for an explained decision at least 20 days before the first scheduled hearing date, the chairperson is required to draft an explained decision and will receive an additional honorarium of $400. The explained decision is a fact-based award stating the general reason(s) for the panel's decision. Arbitrators are not required to include legal authorities and/or damage calculations in the decision.

Absent a joint request from the parties for an explained decision, arbitrators may still include a written decision to be published within the body of the award if they believe that an explanation for the award would benefit the parties. However, if the panel decides on its own to write an explained decision, or at the request of only one party, then no panel member will receive an honorarium for writing the decision.

Note that an award granting a motion to dismiss must be accompanied by a written explanation under FINRA Rule 12504(a), as must an award granting expungement of customer dispute information under FINRA Rule 12805. For more information on writing an explained decision, view our training course available online.

Types of Remedies

Depending upon the relief parties request, there are several types of remedies arbitrators may consider. If the panel is satisfied by a preponderance of the evidence that the respondent is liable for the alleged loss, the panel should determine an appropriate remedy. Remedies may include:

Actual Damages and/or Statutory Damages

Actual damages, sometimes called compensatory damages, are a monetary sum required to compensate a party for their loss. These include:

Net Out-of-Pocket Losses

The calculation of a claimant's net out-of-pocket losses varies depending on whether the panel finds the wrongful conduct involves one or more specific trades or the management of an entire account. For specific trades, net out-of-pocket loss is the purchase price of the security plus commissions minus the total of the value of the security on the relevant date plus dividends or interest received. For wrongful conduct involving an entire account, net out-of-pocket losses are calculated by taking the beginning account value, plus money and securities deposited, minus money and securities withdrawn, less account value on the relevant date. Arbitrators should look to the parties for instructions on these issues.

In addition, some claimants may argue that to award "full compensatory damages" it is necessary to look beyond a claimant's net out-of-pocket loss. These "special" or consequential damages might include:

- lost profits in the form of dividends on stocks sold because of wrongdoing;
- taxes the claimant incurred because of the wrongdoing;
- loss of available funds in the claimant's business;
- loss of financing; and
- commissions paid.

Benefit of the Bargain

The benefit of the bargain measure seeks to give the claimant the expected value of the investment. For example, the claimant's measure of damages would be the amount the investment would have been worth if the respondent's misrepresentation had been true, less what the investment is actually worth. The difficulty with applying the benefit of the bargain measure of damages is determining, with some specificity, the profits that the claimant would have reasonably received.

Well-Managed Portfolio Account

This measure of damage allows the claimant to recover the difference between what the claimant's account made or lost versus what a well-managed account, given the investor's objectives, would have made during the same time period.

Statutory Damages

Sometimes, a claim will be based upon a statute that explains how damages should be calculated. If a claim is based upon such a statute, the panel should look to the parties for guidance on how the law requires damages to be calculated.

Other Remedies

Rescission

Rescission is designed to place the claimant in the same position occupied before the wrongful transaction. It may include the return of the securities at issue.

Disgorgement

The arbitration panel may require the respondent to disgorge profits or commissions. The goal of disgorgement is to make the wrongdoing unprofitable

and therefore deter the wrongdoing. Disgorgement might be available even where the claimant has not suffered net out-of-pocket losses.

Specific Performance

Specific performance requires precise fulfillment of a legal or contractual obligation when monetary damages are inappropriate or inadequate. If the arbitrators determine that specific performance is an appropriate remedy for a case, the award should be specific and clear with respect to:

- the action to be taken;
- the individual who will take the action; and
- if appropriate, when the action will take place.

For example, a panel might determine that rescission of a transaction or agreement is the only way to place the parties back in the position they were before the wrongdoing. If the arbitrators award damages and the claimant has not yet sold the securities, the award should direct what happens to the securities—whether the claimant retains them, sells them, or returns them to the firm, and under what conditions.

Injunctive or Permanent Relief Available in Industry Cases

Temporary Injunctive Relief: Pursuant to FINRA Rule 13804, parties who want a temporary injunction must file for such relief in court. The only related relief available in arbitration at FINRA is for a permanent injunction.

Permanent Relief: FINRA Rule 13804 provides the legal standard an arbitration panel should apply when deciding a request for a permanent injunction. The panel should apply the choice of law as indicated in the parties' agreement, or the law of the state where the events occurred, if the parties do not have an agreement.

Under FINRA Rule 13804, once the panel has heard all evidence on the request for a permanent injunction, it may prohibit the parties from seeking an extension of a court-issued temporary injunction. Arbitrators do not have the authority to modify or dissolve a court's order. However, arbitrators may order the parties to jointly move to modify or dissolve the temporary injunction. If a panel's order conflicts with a pending court order, the panel's order will become effective when the court's order expires.

Requests to Include Interest as Part of the Award

If a party requests the panel to include interest as part of the award, the panel should review the following issues:

- statutory or contractual basis that allows interest to be awarded;
- amount of or rate of interest;
- date interest begins; and
- date interest ends.

The interest rate can vary by jurisdiction and case. Some states specify the legal rate of interest that may be awarded in legal matters. Other jurisdictions use Internal Revenue Service rates or those on treasury bills. In some cases, panels select the rate of interest the broker applies to its own customers for outstanding debts. In general, when awarding interest a panel should apply a reasonable rate that is based on the facts of the case.

With respect to when interest begins to accrue, the arbitrators will generally apply interest from the date a contract was breached or the time the panel determines that a debt became due or payable.

Requests to Include Punitive Damages as Part of the Award

Upon a party's request, arbitrators may consider punitive damages as a remedy if a respondent has engaged in serious misconduct that meets the standards for such an award.

Punitive damages are not intended to right a wrong, but are intended to punish the wrongdoer and to deter future wrongdoing. The standards for awarding punitive damages vary from state to state. While most states permit punitive damages only for conduct that is malicious or intentional, some states permit punitive damages for reckless indifference to the rights of others or for gross negligence.

If punitive damages are awarded, the arbitrators should clearly specify what portion of the award is intended as punitive damages. In addition, arbitrators should include in the award the basis for awarding punitive damages. If the panel needs additional information to determine the basis for awarding punitive damages, it should ask the parties to brief the issue to help determine whether both factual and legal bases exist for such an award.

Awarding Sanctions, if Any

If the panel issues sanctions, pursuant to FINRA Rule 12212, it must include this information in the award. Arbitrators should not make sanctions against parties payable to FINRA as FINRA is not a party to the proceeding. Awards containing monetary sanctions payable to FINRA are inappropriate. Please see the section of this Guide on Issuing Sanctions for additional information.

Awarding Fees and Costs

Arbitrations involve a number of fees and expenses, and the panel decides which party must pay these costs. The panel may ask FINRA staff to provide a summary of all fees that have been incurred as a result of the arbitration, as well as payments made by each party. This section addresses separately the following fees and costs: forum fees; attorneys' fees; witness and production fees; and other case-related costs.

Forum Fees

A party must remit a filing fee when it files a claim, counterclaim, third party claim or cross claim. The cost of the filing fee is based on the amount in dispute and the number of arbitrators assigned to hear a case. Schedules of fees can be found in FINRA Rules FINRA Rules 12900 through 12903, and FINRA Rules 13900 through 13903. Also see the Award Information Sheet for guidance on allocating hearing session fees.

FINRA may temporarily waive fees if the party shows that it is unable to pay the filing fee and/or hearing session deposit. However, FINRA will also inform the party that the panel may still assess arbitration costs at the close of the case.

The total amount of forum fees the arbitrators may assess against the parties is based on the number of hearing sessions needed to complete the hearing. A hearing session includes any meeting between the parties and arbitrator(s) that lasts four hours or less. For example, if a hearing runs two days—eight hours each day—the parties are subject to an assessment of four hearing sessions.

The panel has the discretion to assess forum fees among the parties. In deciding how to allocate the forum fees, arbitrators may consider the following factors:

- temporary waivers of filing fees or hearing session deposits granted because of financial hardship;
- actions by any party that may have prolonged the length of the hearing;
- the legitimacy of arguments made or positions taken;
- disruptions or time delays caused during hearing sessions; and
- the ultimate merits of the case (*i.e.*, who prevailed or substantially prevailed).

Arbitrators should remind the parties periodically that they may be assessed forum fees at the conclusion of the hearing. Although liability may be considered when deciding how to assess fees, it is not the only factor when deciding to assess forum fees.

If the panel elects to assess a postponement fee in its award, it should consider the same factors used in assessing forum fees when assessing this fee. For example, if a party requested and was granted a postponement because another party failed to produce documents, the panel might consider assessing the fee against the non-producing party in the award.

Attorneys' Fees

You may award attorneys' fees when, for example: 1) the parties' contract includes a clause that provides for attorneys' fees; 2) the governing law provides for attorneys' fees when all of the parties request or agree to such fees; 3) the fees are required or permitted as part of a statutory claim; or 4) as otherwise provided by law. FINRA does not provide guidance on whether arbitrators may award attorneys' fees. The law may vary widely and may require interpretation that FINRA, as a neutral forum, will not provide. In addition, you should not conduct your own legal research.

If a party requests the recovery of attorneys' fees and you have questions regarding the panel's authority to award such fees, you should request briefs from the parties that identify the basis for awarding attorneys' fees.

If the panel determines that a party has a right to recovery, that party must prove the amount to the satisfaction of the panel. The panel may permit testimony or evidence to be submitted during the case-in-chief, or in post-hearing written submissions.

Witness and Production Fees

Occasionally, parties may request that the arbitrators direct reimbursement for expenses of a witness, and the costs associated with producing documents. When reviewing witness fees, arbitrators should follow the rule in the applicable jurisdiction. If necessary, the panel should ask the parties to brief the issue.

Usually, each party is responsible for producing and copying documents that they intend to use. According to FINRA Rule 12513 the party requesting the production of documents shall bear all reasonable costs of production, unless the panel directs otherwise. On larger cases, a party might ask that the requesting party come to the location of the documents and copy what is needed.

If the parties cannot agree on who should bear such fees, the panel must find a reasonable solution. After reaching a decision, the panel should memorialize it in an order or the award.

Other Case-Related Costs

The parties may request that the arbitrators direct reimbursement for other expenses, such as:

- cost of transcribing the record;
- travel costs—when the parties have traveled to the hearing and a party has caused the case not to go forward (last-minute postponement request);
- expert fees; and
- teleconference/videoconference fees.

FINRA may also alert the panel to outstanding administrative costs such as:

- photocopying charges;
- mailing charges;
- unpaid postponement fees; and
- unpaid administrative costs.

A panel may assess each of these fees and costs in its award applying equitable principles.

Member Surcharge and Process Fees

Although arbitrators generally have wide latitude in determining how to assess fees and costs against the parties, they do not have discretion in allocating member surcharges and process fees.

FINRA Rules 12901 and 12903 require a brokerage firm to pay a surcharge and process fees when the firm: 1) files a claim; 2) is named as respondent in a claim, counterclaim, cross claim or third party claim; or 3) employed an associated person at the time of the dispute who is named as a respondent in a claim, counterclaim, cross claim or third party claim.

Arbitrators may not reallocate any of the member surcharge or process fees paid by a firm to another party.

Arbitration Award Offsets

Absent specification to the contrary in the award, when arbitrators order opposing parties to make payments to one another, the monetary awards shall offset, and the party assessed the larger amount shall pay the net difference.

Expungement of Customer Dispute Information

Central Registration Depository

The Central Registration Depository (CRD®) is an online registration and licensing system that contains administrative and disclosure information about registered securities firms and brokers. FINRA maintains and operates the CRD system pursuant to FINRA rules and an agreement between FINRA and the North American Securities Administrators Association (NASAA), an association whose members include state and other securities regulators in the United States, as well as other securities regulators in North America.

The CRD system is used by members of the securities industry, state and federal regulators and self-regulatory organizations (SROs). FINRA works with NASAA, the Securities and Exchange Commission (SEC), other members of the regulatory

Under the SRO arbitration rules, all parties are required to exchange documents they intend to present at the hearing and identify all witnesses who will be used in their direct case. This must occur twenty (20) calendar days prior to the first scheduled hearing session, unless extended or shortened by the arbitrator(s) or by agreement of the parties. Arbitrator(s) may bar from use documents not exchanged or witnesses not identified in accordance with this rule. In granting such a motion, arbitrators should consider whether the information was known or available by the day it was required to be exchanged. Again, the arbitrator's duty in deciding this issue is to ensure that all parties are treated fairly.

A common problem is the attempt by a party to present testimony by deposition or affidavit. The first question the panel should ask is, "Why isn't the witness present?" If the witness is properly served with a subpoena, the witness should be at the hearing, unless he or she has a reasonable excuse. Another question the arbitrator should ask is, "Was the opposing party afforded an opportunity to question the witness?" If not, the panel should take this into consideration when deciding whether to accept written testimony or the weight to be given to it.

Although most arbitration claims present questions of fact that the panel will be able to decide on the evidence, some parties may rely on a specific law or statute. Generally, the party who has raised a legal issue will offer the panel a brief setting forth the law or statute and how it applies to the facts of the case. The arbitrators may encourage such a party to cover the issues orally. If the brief is accepted, the other party should be afforded an opportunity to respond. The arbitrators may also request that the parties submit briefs on any issue when the arbitrators feel a brief will assist them in deciding the case.

Attendance of Witnesses at the Hearing

Arbitrators will always have the authority under the Uniform Code to determine who may attend the hearing. Parties must be allowed to attend the hearing. A corporate party may designate a representative as it may choose, whether or not that representative is going to be a fact witness.

Sometimes there is disagreement among the parties as to whether an expert witness should be permitted to attend. Arbitrators should consider that expert witnesses often serve an important role in assisting parties and their counsel in the presentation of their cases, and may also be asked to testify about what has been said at the hearing, in addition to facts known to them prior to the hearing. Absent persuasive reasons to the contrary, there is a presumption that expert witnesses, as opposed to fact witnesses, should be permitted to attend the entire proceedings.

Absent persuasive reasons to the contrary, and subject to the discretion of the arbitrators, the investor party should be permitted to designate one individual to attend the hearing, as there are many instances where an investor wishes to have a spouse, son or daughter, accountant, or other fact witness attend. These people can provide added support to the investor party, and can also provide valuable assistance when hearing the testimony of fact witnesses.

Designations should be made before the hearings start.

Deliberations

Prior to the close of the hearing, the arbitrators may request that the parties state specifically the relief/damages they are seeking if not made clear by the pleadings. The arbitrators may also request that the parties present specific calculations of the damages to assist them in their deliberations.

Immediately after the close of the hearing, the arbitrators usually remain in the hearing room either to begin deliberations or set a date for deliberation. Unlike jurors, the panel members are not restricted from discussing the case among themselves. Generally, arbitrators do not attempt to judge the dispute until all the evidence is received. All arbitrators should take part in the deliberations.

Usually the Chair asks one member of the panel to begin discussion of the case, expressing his or her individual views. The Chair should ask the panelists first to discuss liability without mentioning specific damages. The panelists should discuss differences openly. The arbitrators may wish to review the transcript or recording of the hearing and their notes as well as the evidence.

Arbitrators should keep in mind that the parties expect to be advised of the final decision within thirty (30) business days after the close of the hearing.

The panel may consider breaking the decision into separate awards on each individual claim. Where more than one theory is set forth as a basis for the relief sought, the arbitrators may differ as to these bases for liability. As long as the arbitrators agree on liability, they need not be unanimous on the theory of liability.

Arbitrators are not strictly bound by case precedent or statutory law. Rather, they are guided in their analysis by the underlying policies of the law and are given wide latitude in their interpretation of legal concepts. On the other hand, if an arbitrator manifestly disregards the law, an award may be vacated. (See The Arbitrators' Award)

A. Compensatory/Actual Damages
The recovery of compensatory damages is the primary reason a party brings a claim. An award of compensatory damages may include the party's actual dollar loss and any other damages. Claimants will generally state a figure in the statement of claim of what they consider to be actual damages. Claimants have a duty to prove those damages. All claims for damages should be supported by evidence The arbitrators may consider the concept of mitigation, where appropriate.

B. Punitive Damages
Arbitrators may consider punitive damages as a remedy. Generally, in court proceedings, punitive damages consist of compensation in excess of actual damages and are awarded as a form of punishment against the wrongdoer. If punitive damages are awarded, the arbitrators should clearly specify what portion of the award is intended as punitive damages.

C. Injunctive Relief
Parties may request injunctive relief when they are seeking a specific action or relief from a specific action. For example, an introducing firm may request injunctive relief to enjoin a clearing firm from ceasing to clear its trades. The SROs vary in their approach to injunctive relief issues. Arbitrators should consult the procedures of the SRO in which they are serving.

D. Interest
Arbitrators have the power to award interest and to determine the proper date from which interest is to accrue. Some state statutes specify legal rates of interest that may be used for guidance when awarding interest.

Unless otherwise specified by the arbitrators in the award, all awards shall bear interest from the date of the award: (i) if not paid within thirty (30) days of receipt, (ii) if the award is the subject of a motion to vacate that is denied.

E. Attorneys' Fees
Attorneys' fees are frequently requested in arbitration. Arbitrators have the authority to consider awarding attorneys' fees, but the procedure varies from state to state. It is appropriate for the arbitrators to request the parties to brief this issue.

F. Forum Fees
Some SROs subsidize the arbitration forums they sponsor. In order to defray part of the costs, the arbitrators are empowered to assess forum fees as set forth in the rules. When a party files a Claim, Counterclaim, Third-Party Claim, or Cross-Claim, that party is required to remit a nonrefundable filing fee in addition to a hearing session deposit based upon the fee schedule in the Uniform Code The Director may temporarily waive the fee or deposit. The total fee is

determined by the number of hearing sessions. The arbitrator(s) may assess in the final award a fee waived by the Director

When it is clear that multiple hearing sessions are required, the arbitrator(s) should consider requiring the parties to deposit interim forum fees for additional hearing sessions that have been held or are scheduled

Forum fees may be assessed for prehearing conferences conducted with the parties and an arbitrator. Should a case settle or withdraw subsequent to the commencement of the first hearing session, including a prehearing conference with an arbitrator, the arbitrator(s) may assess forum fees and costs. The assessment should be based on hearing sessions held or scheduled within eight (8) business days after the sponsoring organization receives notice that the matter has been settled or withdrawn.

The arbitrators may also assess an adjournment fee when a party's request for a postponement has been granted, thereby necessitating rescheduling the hearing.

For all of these issues, the arbitrator(s) should refer to the schedule of fees.

In addition to administrative expenses, the parties may request that the arbitrators direct reimbursement for certain expenses such as:

1 the expenses of a witness,
2. the cost associated with producing documents, and
3 the cost of transcribing the record.

It is within the panel's discretion to decide which party, if any, shall pay these fees and expenses. The panel may use the same basis as it did in determining compensatory damages.

The Arbitrators' Award

An arbitrators' award is final and usually not subject to review by the courts unless it can be shown that fraud, corruption, or misconduct occurred in procuring the award. Other grounds for setting aside an award include partiality by an arbitrator or certain specific technical errors. In addition, an award may also be vacated when an arbitrator manifestly disregards the law.

Occasionally, a party will not appear at the arbitration hearing. It is advisable in such cases for the arbitrator to make sure that the nonattending party received due notice of the arbitration hearing and did, in fact, enter into an arbitration agreement The party in attendance still has the obligation of presenting and proving his or her case, and the arbitrator may consider any pleadings submitted by the nonattending party. In any event, despite the nonattendance of a party, the arbitrator may proceed and render an award provided the nonattending party received adequate notice of the hearing.

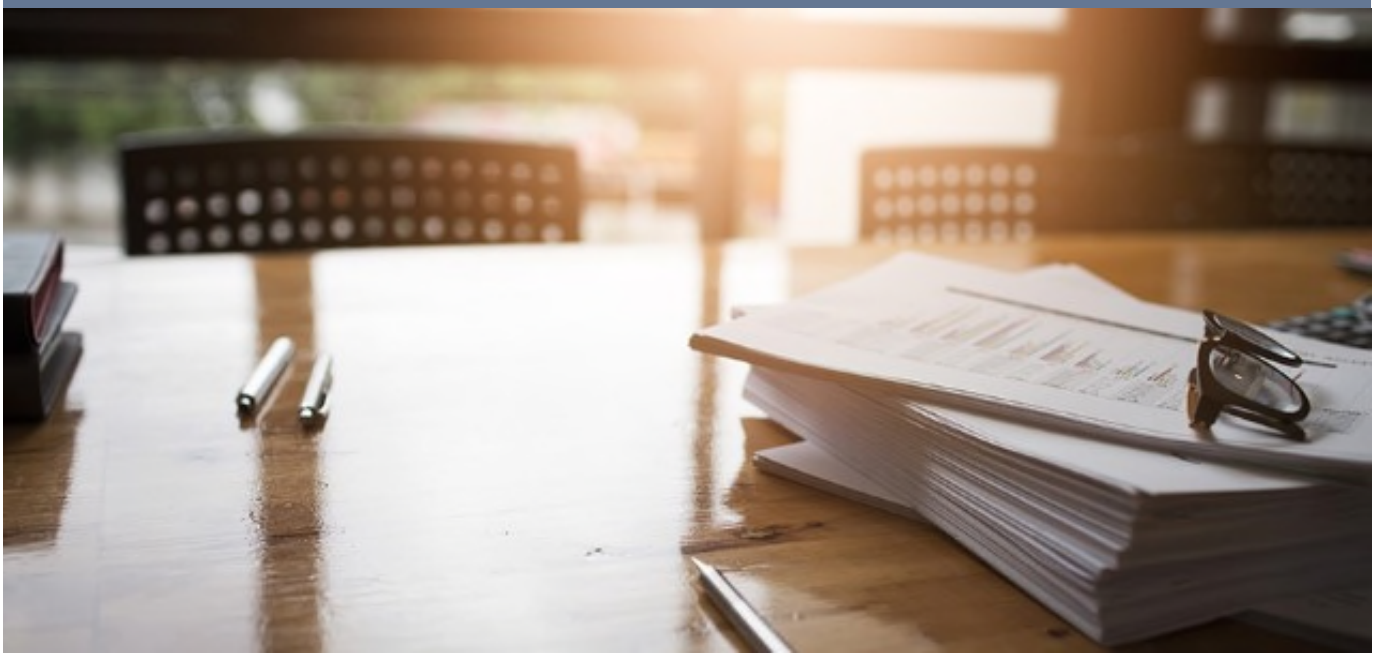
Once a decision is made, the staff member reduces the award to writing Under present law, an arbitrator is not required to give a reason for the decision 3 The award should reflect:

1 the names of the parties,
2. the date the claim was filed and the award rendered,
3. the name(s) of counsel, if any,
4. a summary of the issues, including the type(s) of any security or product in controversy,
5. the amount of the claim or other relief requested and the amount awarded and against whom the award is made,
6. the number and dates of hearing sessions including the location of the hearing,
7. any other matters decided by the arbitrators, such as jurisdictional issues, and,
8. the names of the arbitrator(s) and the signatures of the arbitrator(s) concurring in the award.

Brokerage Accounts

SEC Regulation Best Interest and Form CRS: What You Need to Know

JUNE 30, 2020 | FINRA Staff



On June 30, 2020, new rules take effect that are designed to help retail investors better understand and navigate their relationships with investment professionals and make informed choices about the type of relationship for their needs and circumstances. The new Securities and Exchange Commission (SEC) rules, among other things, enhance the standard of conduct broker-dealers must provide to their retail customers and require broker-dealers and SEC-registered investment advisers (RIAs) to provide a new relationship summary — Form CRS — to retail investors. Here is what you need to know.

What is Regulation Best Interest?

Regulation Best Interest, or Reg BI, establishes a "best interest" standard of conduct for broker-dealers and their associated persons when they make a recommendation to a retail customer of any securities transaction, or investment strategy involving securities. This means that when making a recommendation to a retail customer, a broker-dealer must act in the retail customer's best interests and not place its own interests ahead of the customer's interests. This includes recommendations of types of accounts, such as IRA rollovers, or a recommendation to open a broker-dealer or investment advisory account.

To meet the standard of conduct required by Reg BI, broker-dealers must meet certain component obligations that include, but are not limited to, making important disclosures to customers about the services they provide and fees they charge, and identifying and managing conflicts of interest that might compromise their obligations to customers. To learn more, visit the SEC's website here.

What is Form CRS?

The new rules require broker-dealers and RIAs to provide a brief relationship summary, Form CRS, to retail investors. The relationship summary contains important information about the firm, including disclosures about key information that can help you decide if a firm is right for you. It also provides a standardized way for investors to compare information about different firms.

Form CRS will provide customers with information about:

- the types of services the firm offers;
- the fees, costs, conflicts of interest, and required standard of conduct associated with those services;
- whether the firm and its investment professionals have reportable legal or disciplinary history; and,
- how to get more information about the firm.

Form CRS also includes questions to help begin a discussion with a RIA or broker-dealer about the relationship, including their services, fees, costs, conflicts, and disciplinary information. In addition, each relationship summary will provide a link to the SEC's Form CRS webpage that has information specifically tailored to educate investors about different types of investment professionals and what they can offer you.

When Will I Receive a Relationship Summary?

If you are currently working with an investment professional, you should receive a relationship summary by July 30, 2020. In addition, RIAs must provide the relationship summary to each new or prospective client who is a retail investor before or at the time of entering into an advisory agreement. Broker-dealers must provide the relationship summary before or at the earliest of:

- a recommendation of account type, security or investment strategy;
- placing an order for the retail investor; or
- opening a brokerage account.

Firms are also required to deliver the relationship summary at various times, for example, if they recommend that you roll over assets from a retirement account into a new or existing account or investment. Firms have an obligation to update the relationship summary within 30 days from when it becomes materially inaccurate. You can expect to receive a firm's relationship summary in paper or electronic form, depending on how you have chosen to receive disclosures from your firm, and it will also be available on the firm's public website. In addition, you can search for a firm's relationship summary, and find more information about a firm, using a free and simple search tool on the SEC's Investor.gov.

Also don't forget to take advantage of the SEC's Investment Adviser Public Disclosure website and FINRA's BrokerCheck to check out the background and disciplinary history of any RIA or broker-dealer you are considering doing business with.

Subscribe to FINRA's The Alert Investor newsletter for more information about saving and investing.

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Regulatory Notice 20-18

Reg BI-Related Changes to FINRA Rules

FINRA Amends Its Suitability, Non-Cash Compensation and Capital Acquisition Broker (CAB) Rules in Response to Regulation Best Interest

Effective Date: June 30, 2020

June 19, 2020

Notice Type
- Rule Amendment

Suggested Routing
- Compliance
- Legal
- Operations
- Senior Management

Key Topics
- Best Interest Standard of Conduct
- Non-Cash Compensation
- Suitability

Referenced Rules & Notices
- CAB Rule 211
- FINRA Rule 2111
- FINRA Rule 2310
- FINRA Rule 2320
- FINRA Rule 2341
- FINRA Rule 5110
- Regulation Best Interest
- Securities Exchange Act of 1934

Summary

FINRA has amended its suitability rule, Capital Acquisition Broker (CAB) suitability rule and rules governing non-cash compensation to provide clarity on which standard applies and to address potential inconsistencies with the Securities and Exchange Commission's (SEC's) Regulation Best Interest (Reg BI).[1] These changes have been approved by the SEC and become effective on June 30, 2020, the compliance date of Reg BI.

The text of the amended rules is set forth in Attachment A.

Questions regarding this *Notice* should be directed to:

- James S. Wrona, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8270 or *jim.wrona@finra.org*;
- Joseph P. Savage, Vice President, OGC, at (240) 386-4534 or *joe.savage@finra.org*; or
- Meredith Cordisco, Associate General Counsel, OGC, at (202) 728-8018 or *meredith.cordisco@finra.org*.

Discussion

On June 5, 2019, the SEC adopted Reg BI under the Securities Exchange Act of 1934 (Exchange Act).[2] Reg BI establishes a "best interest" standard of conduct for broker-dealers and associated persons when they make a recommendation to a retail customer of any securities transaction or investment strategy involving securities, including recommendations of types of accounts. Among other things, Reg BI incorporates and enhances principles that are also found in FINRA Rule 2111 (Suitability). To provide clarity over which standard applies, FINRA has amended its suitability rule to state that Rule 2111 does not apply to recommendations that are subject to Reg BI.

Reg BI also requires broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited time period. To avoid potential inconsistencies, FINRA has amended its non-cash compensation rules to provide that the practices addressed by those rules also must be consistent with Reg BI.

Suitability

FINRA Rule 2111 requires, in part, that a broker-dealer or associated person "have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the firm or associated person to ascertain the customer's investment profile." The rule identifies the three main suitability obligations: reasonable-basis, customer-specific and quantitative suitability.

Reg BI's Care Obligation addresses the same conduct with respect to retail customers that is addressed by Rule 2111, but employs a best interest, rather than a suitability, standard, in addition to other key enhancements. Absent action by FINRA, a broker-dealer would be required to comply with both Reg BI and Rule 2111 regarding recommendations to retail customers. In such circumstances, compliance with Reg BI would result in compliance with Rule 2111 because a broker-dealer that meets the best interest standard would necessarily meet the suitability standard.

To provide clarity on which standard applies and to avoid unnecessary duplication, FINRA has amended Rule 2111 to state that it will not apply to recommendations subject to Reg BI.[3] FINRA has also removed the element of control from the quantitative suitability obligation, a change that is consistent with Reg BI.[4] Finally, FINRA has conformed the CAB suitability rule, CAB Rule 211, to the amendments to Rule 2111.

Non-Cash Compensation

FINRA Rules 2310 (Direct Participation Programs), 2320 (Variable Contracts of an Insurance Company), 2341 (Investment Company Securities), and 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements) each includes provisions restricting the payment and receipt of non-cash compensation in connection with the sale and distribution of securities governed by those rules.[5]

As noted above, Reg BI's Conflict of Interest Obligation requires broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited time period.[6] To avoid any potential inconsistency between the FINRA non-cash compensation rules and Reg BI's limitations in this area, FINRA has amended its rules to ensure that the arrangements addressed must also be consistent with the applicable requirements of Reg BI.[7]

Endnotes

1. *See* Securities Exchange Act Release No. 89091 (June 18, 2020) (Order Granting Approval of File No. SR-FINRA-2020-007).

2. 17 CFR 240.15*l*-1. *See* Exchange Act Release No. 86031 (June 5, 2019), 84 FR 33318 (July 12, 2019) (Reg BI Release).

3. *See* FINRA Rule 2111.08. FINRA has not eliminated its suitability rule because there will be recommendations that will not be subject to Reg BI but that would still warrant suitability protections. For example, before these changes, FINRA Rule 2111 applied broadly to all recommendations to customers (albeit with an exemption to customer-specific suitability for recommendations to institutional customers under specified circumstances). Reg BI applies only to recommendations to "retail customers," which Reg BI defines as a natural person, or the legal representative of such natural person, who receives a recommendation of any securities transaction or investment strategy involving securities from a broker-dealer and uses the recommendation primarily for personal, family, or household purposes. *See* 17 CFR 240.15*l*-1(b)(1). Thus, FINRA's suitability rule is still needed for entities and institutions (*e.g.,* pension funds), and natural persons who will not use recommendations primarily for personal, family, or household purposes (*e.g.,* small business owners and charitable trusts). In addition, other FINRA rules that have a suitability or suitability-like component (*e.g.,* FINRA Rule 2330 (Members' Responsibilities Regarding Deferred Variable Annuities) and FINRA Rule 2360 (Options)) are not impacted by these rule changes and remain in place.

4. *See* Reg BI Release, 84 FR at 33384.

5. As a general matter, these rules limit non-cash compensation arrangements to: (1) gifts that do not exceed $100 in value and that are not preconditioned on the achievement of a sales target; (2) an occasional meal, a ticket to a sporting event or the theater, or other comparable entertainment that does not raise any question of propriety and is not preconditioned on the achievement of a sales target; (3) payment or receipt by "offerors" (generally product sponsors and their affiliates) in connection with training or education meetings, subject to specified conditions, including that the payment of such compensation is not conditioned on achieving a sales target; and (4) internal non-cash compensation arrangements between a member and its associated persons, subject to specified conditions. If the internal noncash compensation arrangement is in the form of a contest in connection with the sale and distribution of variable insurance contracts or investment company securities, the contest must be based on the total production of associated persons with respect to all securities within those product categories, and credit for those sales must be equally weighted. *See* FINRA Rules 2320(g)(4)(D) and 2341(l)(5)(D). Rules 2310(c)(2)(D) and 5110(h)(2)(D) do not require internal non-cash compensation arrangements in connection with the sale and distribution of direct participation programs or public offerings of securities to be based on total production and equal weighting of securities sales.

6. *See* 17 CFR 240.15l-1(a)(2)(iii)(D).

7. *See* FINRA Rules 2310(c)(2), 2320(g)(4), 2341(l) and 5110(h)(2). The purpose of these amendments is to ensure that these rules' limits on non-cash compensation are read consistently with the SEC staff's interpretations of Reg BI, including in particular paragraph (a)(2)(iii)(D).

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ATTACHMENT A

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

2000. DUTIES AND CONFLICTS

* * * * *

2100. TRANSACTIONS WITH CUSTOMERS

* * * * *

2110. Recommendations

* * * * *

2111. Suitability

(a) through (b) No Change.

• • • Supplementary Material: ----------

.01 through .04 No Change.

.05 Components of Suitability Obligations. Rule 2111 is composed of three main obligations: reasonable-basis suitability, customer-specific suitability, and quantitative suitability.

(a) through (b) No Change.

(c) Quantitative suitability requires a member or associated person [who has actual or de facto control over a customer account] to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile, as delineated in Rule 2111(a). No single test defines excessive activity, but factors such as the turnover rate, the cost-equity ratio, and the use of in-and-out trading in a customer's account may provide a basis for a finding that a member or associated person has violated the quantitative suitability obligation.

.06 through .07 No Change.

.08 Regulation Best Interest. This Rule shall not apply to recommendations subject to SEA Rule 15l-1 ("Regulation Best Interest").

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2300. SPECIAL PRODUCTS

* * * * *

2310. Direct Participation Programs

(a) through (b) No Change.

(c) Non-Cash Compensation

(1) No Change.

(2) Restriction on Non-Cash Compensation

In connection with the sale and distribution of direct participation program or REIT securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided below[in this provision]. Non-cash compensation arrangements must be consistent with the applicable requirements of SEA Rule 15l-1 ("Regulation Best Interest") and are limited to the following:

(A) through (E) No Change.

(d) No Change.

2320. Variable Contracts of an Insurance Company

(a) through (f) No Change.

(g) Member Compensation

In connection with the sale and distribution of variable contracts:

(1) through (3) No Change.

(4) No member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided below [in this provision]. Notwithstanding the provisions of paragraph (g)(1), the following non-cash compensation arrangements are permitted provided that they are consistent with the applicable requirements of SEA Rule 15l-1 ("Regulation Best Interest"):

(A) through (E) No Change.

* * * * *

2341. Investment Company Securities

(a) through (k) No Change.

(l) Member Compensation

In connection with the sale and distribution of investment company securities:

(1) through (4) No Change.

(5) No member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided below [in this provision]. Notwithstanding the provisions of paragraph (l)(1), the following non-cash compensation arrangements are permitted provided that they are consistent with the applicable requirements of SEA Rule 15l-1 ("Regulation Best Interest"):

(A) through (E) No Change.

(m) through (n) No Change.

* * * * *

5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

* * * * *

5110. Corporate Financing Rule — Underwriting Terms and Arrangements

(a) through (g) No Change.

(h) Non-Cash Compensation

(1) No Change.

(2) Restrictions on Non-Cash Compensation

In connection with the sale and distribution of a public offering of securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided below [in this provision]. Non-cash compensation arrangements must be consistent with the applicable requirements of SEA Rule 15l-1 ("Regulation Best Interest") and are limited to the following:

(A) through (E) No Change.

(i) No Change.

* * * * *

CAPITAL ACQUISITION BROKER RULES

* * * * *

200. DUTIES AND CONFLICTS

* * * * *

211. Suitability

(a) through (b) No Change.

• • • Supplementary Material: ----------

.01 through .02 No Change.

.03 Regulation Best Interest. This Rule shall not apply to recommendations subject to SEA Rule 15l-1 ("Regulation Best Interest").

2165. Financial Exploitation of Specified Adults

(a) Definitions

(1) For purposes of this Rule, the term "Specified Adult" shall mean: (A) a natural person age 65 and older; or (B) a natural person age 18 and older who the member reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests.

(2) For purposes of this Rule, the term "Account" shall mean any account of a member for which a Specified Adult has the authority to transact business.

(3) For purposes of this Rule, the term "Trusted Contact Person" shall mean the person who may be contacted about the Specified Adult's Account in accordance with Rule 4512.

(4) For purposes of this Rule, the term "financial exploitation" means:

(A) the wrongful or unauthorized taking, withholding, appropriation, or use of a Specified Adult's funds or securities; or

(B) any act or omission by a person, including through the use of a power of attorney, guardianship, or any other authority regarding a Specified Adult, to:

(i) obtain control, through deception, intimidation or undue influence, over the Specified Adult's money, assets or property; or

(ii) convert the Specified Adult's money, assets or property.

(b) Temporary Hold on Disbursements

(1) A member may place a temporary hold on a disbursement of funds or securities from the Account of a Specified Adult if:

(A) The member reasonably believes that financial exploitation of the Specified Adult has occurred, is occurring, has been attempted, or will be attempted; and

(B) The member, not later than two business days after the date that the member first placed the temporary hold on the disbursement of funds or securities, provides notification orally or in writing, which may be electronic, of the temporary hold and the reason for the temporary hold to:

(i) all parties authorized to transact business on the Account, unless a party is unavailable or the member reasonably believes that the party has engaged, is engaged, or will engage in the financial exploitation of the Specified Adult; and

(ii) the Trusted Contact Person(s), unless the Trusted Contact Person is unavailable or the member reasonably believes that the Trusted Contact Person(s) has engaged, is engaged, or will engage in the financial exploitation of the Specified Adult; and

(C) The member immediately initiates an internal review of the facts and circumstances that caused the member to reasonably believe that the financial exploitation of the Specified Adult has occurred, is occurring, has been attempted, or will be attempted.

(2) The temporary hold authorized by this Rule will expire not later than 15 business days after the date that the member first placed the temporary hold on the disbursement of funds or securities, unless otherwise terminated or extended by a state regulator or agency of competent jurisdiction or a court of competent jurisdiction, or extended pursuant to paragraph (b)(3) of this Rule.

(3) Provided that the member's internal review of the facts and circumstances under paragraph (b)(1)(C) of this Rule supports the member's reasonable belief that the financial exploitation of the Specified Adult has occurred, is occurring, has been attempted, or will be attempted, the temporary hold authorized by this Rule may be extended by the member for no longer than 10 business days following the date authorized by paragraph (b)(2) of this Rule, unless otherwise terminated or extended by a state regulator or agency of competent jurisdiction or a court of competent jurisdiction.

(c) Supervision

(1) In addition to the general supervisory and recordkeeping requirements of Rules 3110, 3120, 3130, 3150, and Rule 4510 Series, a member relying on this Rule shall establish and maintain written supervisory procedures reasonably designed to achieve compliance with this Rule, including, but not limited to, procedures related to the identification, escalation and reporting of matters related to the financial exploitation of Specified Adults.

(2) A member's written supervisory procedures also shall identify the title of each person authorized to place, terminate or extend a temporary hold on behalf of the member pursuant to this Rule. Any such person shall be an associated person of the member who serves in a supervisory, compliance or legal capacity for the member.

(d) Record Retention

Members shall retain records related to compliance with this Rule, which shall be readily available to FINRA, upon request. The retained records shall include records of: (1) request(s) for disbursement that may constitute financial exploitation of a Specified Adult and the resulting temporary hold; (2) the finding of a reasonable belief that financial exploitation has occurred, is occurring, has been attempted, or will be attempted underlying the decision to place a temporary hold on a disbursement; (3) the name and title of the associated person that authorized the temporary hold on a disbursement; (4) notification(s) to the relevant parties pursuant to paragraph (b)(1)(B) of this Rule; and (5) the internal review of the facts and circumstances pursuant to paragraph (b)(1)(C) of this Rule.

• • • Supplementary Material: ----------

.01 Applicability of Rule. This Rule provides members and their associated persons with a safe harbor from FINRA Rules 2010, 2150 and 11870 when members exercise discretion in placing temporary holds on disbursements of funds or securities from the Accounts of Specified Adults consistent with the requirements of this Rule. This Rule does not require members to place temporary holds on disbursements of funds or securities from the Accounts of Specified Adults.

.02 Training. A member relying on this Rule must develop and document training policies or programs reasonably designed to ensure that associated persons comply with the requirements of this Rule.

.03 Reasonable Belief of Mental or Physical Impairment. A member's reasonable belief that a natural person age 18 and older has a mental or physical impairment that renders the individual unable to protect his or her own interests may be based on the facts and circumstances observed in the member's business relationship with the natural person.

Adopted by SR-FINRA-2016-039 eff. Feb. 5, 2018.

Selected Notice: 17-11.

‹ 2150. IMPROPER USE OF CUSTOMERS' SECURITIES OR FUNDS; PROHIBITION AGAINST GUARANTEES AND SHARING IN ACCOUNTS

UP

2200. COMMUNICATIONS AND DISCLOSURES ›

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4512. Customer Account Information

The Rule | Notices

(a) Each member shall maintain the following information:

(1) for each account:

(A) customer's name and residence;

(B) whether customer is of legal age;

(C) name(s) of the associated person(s), if any, responsible for the account, and if multiple individuals are assigned responsibility for the account, a record indicating the scope of their responsibilities with respect to the account, provided, however, that this requirement shall not apply to an institutional account;

(D) signature of the partner, officer or manager denoting that the account has been accepted in accordance with the member's policies and procedures for acceptance of accounts;

(E) if the customer is a corporation, partnership or other legal entity, the names of any persons authorized to transact business on behalf of the entity; and

(F) subject to Supplementary Material .06, name of and contact information for a trusted contact person age 18 or older who may be contacted about the customer's account; provided, however, that this requirement shall not apply to an institutional account.

(2) for each account other than an institutional account, and accounts in which investments are limited to transactions in open-end investment company shares that are not recommended by the member or its associated persons, each member shall also make reasonable efforts to obtain, prior to the settlement of the initial transaction in the account, the following information to the extent it is applicable to the account:

(A) customer's tax identification or Social Security number;

(B) occupation of customer and name and address of employer; and

(C) whether customer is an associated person of another member; and

(3) for discretionary accounts maintained by a member, in addition to compliance with subparagraph (1) and, to the extent applicable, subparagraph (2) above, and Rule 3260, the member shall maintain a record of the dated, signature of each named, associated person of the member authorized to exercise discretion in the account. This recordkeeping requirement shall not apply to investment discretion granted by a customer as to the price at which or the time to execute an order given by a customer for the purchase or sale of a definite dollar amount or quantity of a specified security. Nothing in this Rule shall be construed as allowing members to maintain discretionary accounts or exercise discretion in such accounts except to the extent permitted under the federal securities laws.

(b) A member need not meet the requirements of this Rule with respect to any account that was opened pursuant to a prior FINRA rule until such time as the member updates the information for the account either in the course of the member's routine and customary business or as otherwise required by applicable laws or rules.

(c) For purposes of this Rule, the term "institutional account" shall mean the account of:

(1) a bank, savings and loan association, insurance company or registered investment company;

(2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or

(3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least $50 million.

• • • Supplementary Material: ----------

.01 Customer Account Information Retention Periods. For purposes of this Rule, members shall preserve a record of any customer account information that subsequently is updated for at least six years after the date that such information is updated. Members shall preserve a record of the last update to any customer account information, or the original account information if there are no updates to the account information, for at least six years after the date the account is closed.

.02 Additional Customer Account Records Under the Exchange Act. Members should be aware that they may be required to make and preserve additional customer account records as required under Section 17(a) of the Exchange Act and the applicable associated Exchange Act rules.

.03 Compliance With Rule 2070. With respect to paragraph (a)(2)(B) of this Rule, members should be aware that they have an obligation to comply with the requirements of Rule 2070(a) if they have actual notice that a customer having a financial interest in, or controlling trading in, an account is an employee of FINRA.

.04 "Maintain" and "Preserve." For purposes of Rule 4512 only, as a general matter, the term "maintain" is used to reflect customer account information that is current or in use. The term "preserve" is used to reflect customer account information that is no longer current or in use.

.05 Supervision of Accounts. Nothing in paragraph (a)(1)(C) of this Rule obviates a member's obligation to supervise an account that it services, including determining the associated persons responsible for the account and ensuring that such persons are appropriately qualified and registered, and to comply with the requirements of Rule 2090 (effective July 9, 2012). With respect to a member's obligation to supervise an account, it is incumbent upon the member to design appropriate mechanisms to determine the associated persons responsible for the account, ensure that such persons are appropriately qualified and registered, and have the ability to provide such information to FINRA or SEC staff upon request.

.06 Trusted Contact Person

(a) With respect to paragraph (a)(1)(F) of this Rule, at the time of account opening a member shall disclose in writing, which may be electronic, to the customer that the member or an associated person of the member is authorized to contact the trusted contact person and disclose information about the customer's account to address possible financial exploitation, to confirm the specifics of the customer's current contact information, health status, or the identity of any legal guardian, executor, trustee or holder of a power of attorney, or as otherwise permitted by Rule 2165. With respect to any account that was opened pursuant to a prior FINRA rule, a member shall provide this disclosure in writing, which may be electronic, when updating the information for the account pursuant to paragraph (b) of this Rule either in the course of the member's routine and customary business or as otherwise required by applicable laws or rules.

(b) The absence of the name of or contact information for a trusted contact person shall not prevent a member from opening or maintaining an account for a customer, provided that the member makes reasonable efforts to obtain the name of and contact information for a trusted contact person.

(c) With respect to any account subject to the requirements of SEA Rule 17a- 3(a)(17) to periodically update customer records, a member shall make reasonable efforts to obtain or, if previously obtained, to update where appropriate the name of and contact information for a trusted contact person consistent with the requirements of SEA Rule 17a-3(a)(17).

Amended by SR-FINRA-2019-009 eff. May 8, 2019.
Amended by SR-FINRA-2018-040 eff. May 6, 2019.
Amended by SR-FINRA-2016-039 eff. Feb. 5, 2018.
Amended by SR-FINRA-2011-070 eff. Dec. 5, 2011.
Adopted by SR-FINRA-2010-052 eff. Dec. 5, 2011.

Selected Notices: 11-19, 17-11, 19-13.

‹ 4511. GENERAL REQUIREMENTS UP 4513. RECORDS OF WRITTEN CUSTOMER COMPLAINTS ›

VERSIONS

May 08, 2019 onwards

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Protecting Senior Investors 2015–2020

An Update on the FINRA Securities Helpline for Seniors, Other FINRA Initiatives and Member Firm Practices

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I. Introduction

Seniors make up an increasingly large share of the American population[1] and hold higher levels of wealth than other generations. These factors, among others, make seniors an attractive target for financial exploitation, with evidence suggesting that such exploitation has been increasing in terms of both scope and magnitude.[2] Sadly, while seniors sometimes fall victim to financial exploitation by strangers, they are often exploited by individuals they know and trust, such as family members or caregivers. Senior investors who are isolated or suffering from cognitive decline may be particularly vulnerable to harm.[3]

FINRA has maintained a longstanding commitment to protecting senior investors and continues to work to address risks facing this investor population as part of our regulatory mission, including by:

- Launching the dedicated FINRA Securities Helpline for Seniors (the Helpline) in April 2015;
- Conducting rulemaking to give firms tools to address suspected financial exploitation of senior investors and other vulnerable adults;
- Identifying senior investor issues as a priority for our risk monitoring and examination programs;
- Bringing disciplinary actions for misconduct against senior investors;
- Collaborating with other regulators and organizations to address senior investor protection; and
- Funding and conducting research on senior investors and fraud, and educating investors on potential risks.

FINRA is issuing this report to provide an update on these initiatives to help senior investors on the occasion of the Helpline's five-year anniversary.[4] This report describes the impact of the Helpline and highlights cases that illustrate its broad impact. In addition, the report provides insight into FINRA's ongoing work to protect senior investors beyond the Helpline, including targeted rulemaking in this area, and share effective practices observed during our firm examinations.

Helpline Staff Goes Above and Beyond

The Helpline received a call from a 99-year-old investor who had received a letter from her brokerage firm stating that her current registered representative was no longer assigned to her account. She was afraid to change to a new registered representative and she asked the Helpline staff for help with reviewing the letter. The caller told Helpline staff that she did not drive, had three recent surgeries, and was on medication that affected her cognitive abilities. She also shared that she did not have family or friends who she could trust to help her make financial decisions. Her main investment goal was to maximize the assets she could leave to wounded war veterans. To accommodate her physical limitations, Helpline staff took the initiative to drive to the caller's home, review the documents with her, and help her contact her firm to select a new registered representative.

The Helpline is available at 844-57-HELPS, Monday to Friday, 9 am – 5 pm (ET).

The Appendix lists resources on senior investor protection resources from FINRA, U.S. Securities and Exchange Commission (SEC), North American Securities Administrators Association (NASAA), Financial Crimes Enforcement Network (FinCEN) and Consumer Financial Protection Bureau (CFPB).

If you would like to share general comments or have questions regarding this report, please send them to Elena Schlickenmaier, Member Supervision, *Elena.Schlickenmaier@finra.org* or Steven Polansky, Member Supervision, at *Steven.Polansky@finra.org*.

II. The Helpline in Action

Overview

FINRA launched the Helpline on April 20, 2015 to provide investors with access to specially trained FINRA staff who can assist senior and vulnerable adult investors with questions or concerns about their brokerage accounts and investments. As of December 31, 2019,[5] the Helpline has received over 18,000 calls from all 50 states and several countries. Helpline callers range in age from 17 to 102, with the majority of calls coming directly from seniors (with an average age of 70). The Helpline has made over 1,400 referrals to state, federal and international regulators, as well as over 200 referrals to state Adult Protective Services (APS), and assisted with the return of over $7 million to investors. This section describes in greater detail many of the Helpline's significant accomplishments and the scope of its impact, including its guidance to callers, partnerships with firms, collaboration with other regulators and organizations, and support for FINRA's and other regulators' regulatory actions.

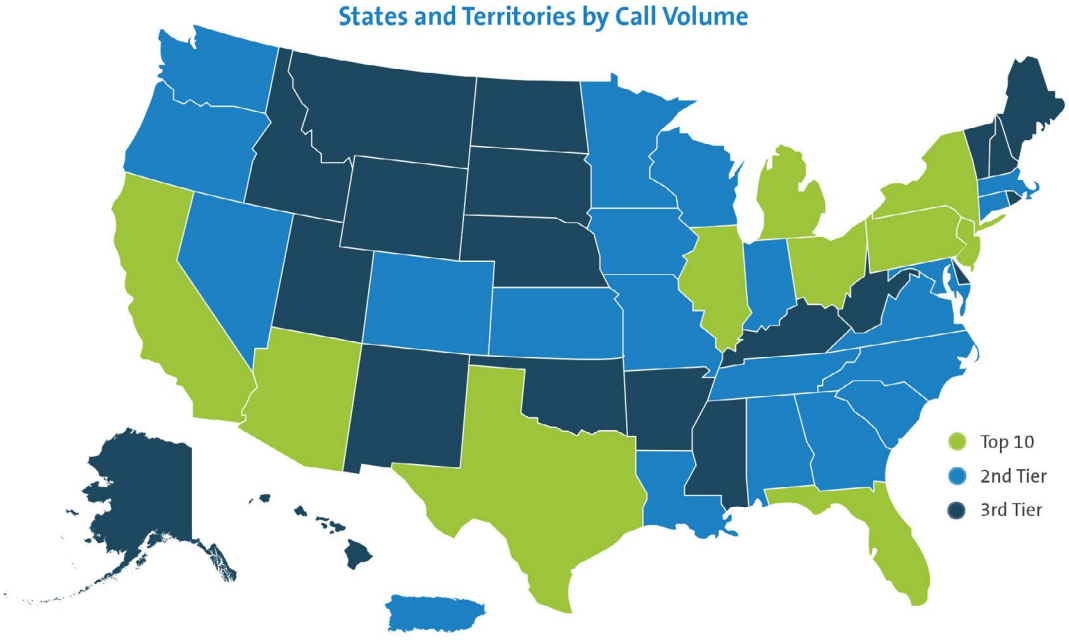
The Helpline staff answer questions and provide assistance on wide-ranging topics across the securities industry and escalate issues within FINRA or to other regulators—such as the SEC, state regulators, APS or international regulators—when there is potential evidence of misconduct. Helpline staff receive specialized training to prepare them to respond to and, where possible, resolve callers' questions, which may include contacting firms to resolve problems or clarify questions, obtaining restitution for customers, performing additional research, and connecting callers with FINRA and other resources. In addition, Helpline staff collaborate with the FINRA Foundation on outreach and communications to investors.

Partnership with FINRA Member Firms

The Helpline's success depends in large measure on the commitment of our member firms to proactively address concerns relating to senior investors. Since the Helpline's inception in 2015, firms have returned more than **$7 million** to customers in matters discussed with the Helpline staff. The Helpline continues to engage in open dialogue with firms about issues raised during calls and partners with many firms to bring prompt resolution to customer issues and concerns. In some situations, firms proactively reach out to Helpline staff to share concerns and discuss possible courses of action for senior customers facing potential financial exploitation. In addition, Helpline staff, in coordination with FINRA's Office of Financial Innovation, engaged in discussions to learn how some vendors' account monitoring tools can assist in addressing the risks of financial exploitation and diminished capacity for senior investors.

Call Volume and Geographic Reach

The volume of calls to the Helpline has been consistently high, and the reach of the Helpline—across the United States and, in some cases, other countries—is broad. The Helpline has received calls from all 50 states, the District of Columbia, Puerto Rico and the Virgin Islands. In addition, the Helpline has received calls from both U.S. and foreign citizens living in Australia, the United Kingdom, Canada, Israel, South Africa, Kenya, China, Uzbekistan and Namibia.



Helpline Staff Provides Information to Firm, Which Reinstates Guaranteed Lifetime Income for Customer

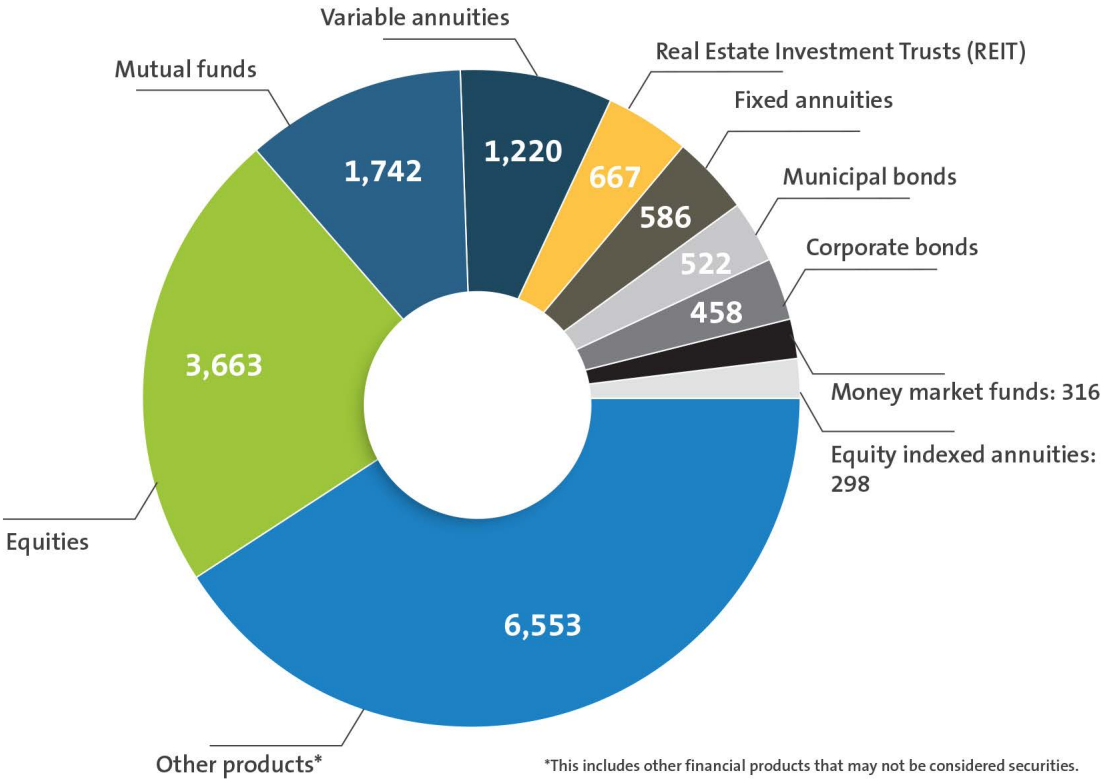
A senior investor contacted the Helpline because her monthly guaranteed lifetime annuity payment dropped without explanation. The Helpline staff worked with her firm to determine that her registered representative misstated the guaranteed income amount and, as a result, the customer was withdrawing extra funds from the annuity's principal without understanding the implications of those withdrawals. Due to the information provided by the Helpline staff, the firm offered to make the customer whole by providing her with a lump sum of more than $180,000 to purchase a fixed immediate annuity that would bring her guaranteed income up to the level originally stated by the registered representative.

As of December 31, 2019, the Helpline had received over 18,000 calls. The average wait time for callers is under two minutes and the staff spends, on average, about 24 minutes with each caller.

Number of Calls



Top 10 Products Discussed by Callers

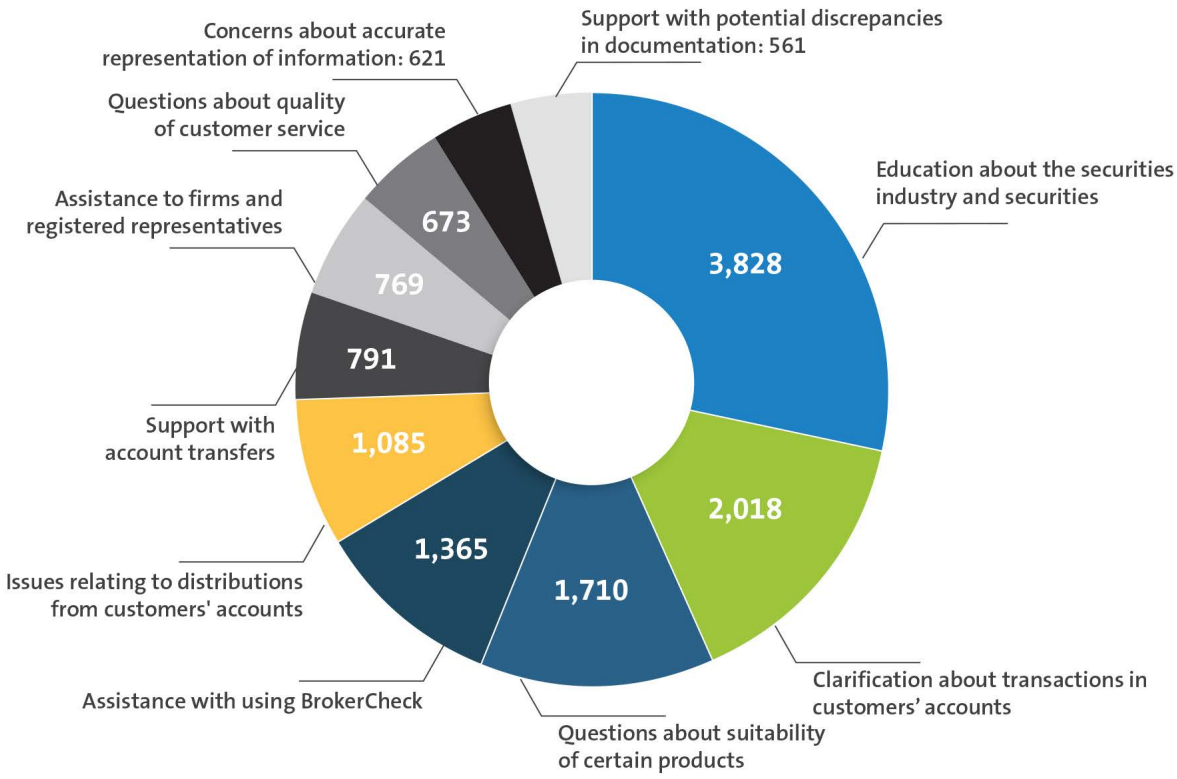


*This includes other financial products that may not be considered securities.

Topics Addressed in Calls

Senior investors, their family members or their registered representatives reach out to the Helpline to request support regarding a broad range of issues. Some callers request guidance with accessing background information about their registered representatives in BrokerCheck, whereas others raise concerns about other possible misconduct, such as fraud, financial exploitation or sales practice activity.

Top 10 Topics



Helpline Staff Contact Firm, Which Reassesses Suitability of Fixed Annuity and Refunds Senior Investor Almost $300,000

A senior investor contacted the Helpline with concerns about potentially unsuitable recommendations. The senior investor stated that her registered representative recommended she liquidate her existing IRA to invest in a fixed annuity. The senior investor thought the registered representative misrepresented the product and did not explain that the product was a fixed annuity. When Helpline staff contacted the firm, it reevaluated the suitability of the product for the senior investor, rescinded the fixed annuity contract, and refunded the customer the original purchase payment of $291,239.

Helpline Assists Enforcement, which Bars Registered Representative for Churning Senior Investor's Accounts

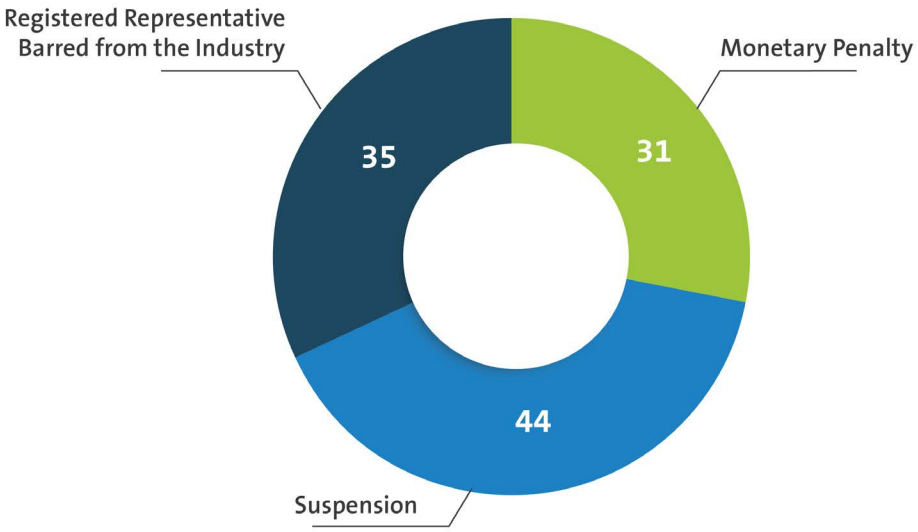
An individual contacted the Helpline regarding concerns about churning in a 93-year-old senior investor's account, over which the individual held power of attorney. FINRA found that the registered representative on the account effected over 2,800 transactions in four separate accounts for that senior investor, resulting in $581,650 in commissions, $84,270 in other fees and approximately $397,000 in trading losses. FINRA barred the registered representative from the securities industry.[6]

FINRA Actions Arising from Helpline Matters

Some of the calls received by the Helpline require further investigation–including by FINRA's Departments of Member Supervision and Enforcement–if the Helpline staff observe potential financial exploitation or other misconduct.

Calls to the Helpline have led to FINRA imposing sanctions–including bars, monetary penalties and suspensions–on firms and registered representatives found to have engaged in misconduct relating to senior investors.

Enforcement Sanctions Arising from Helpline Matters



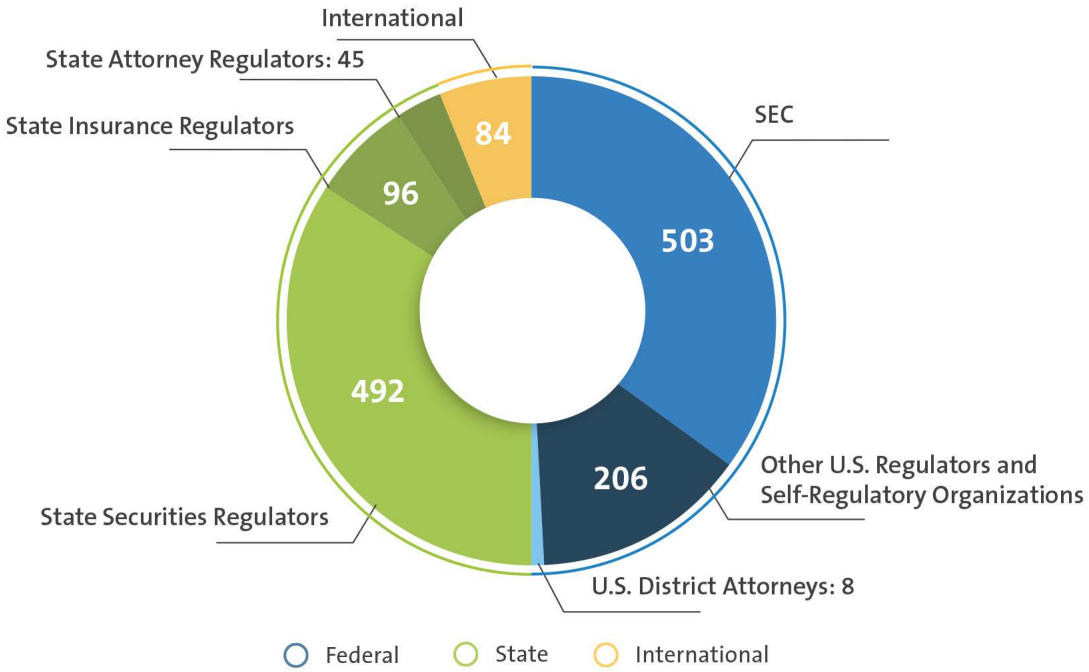
Helpline Assists Enforcement with Barring Registered Representative Who Opened Unauthorized Joint Account with Senior Investor

An anonymous tipster contacted the Helpline after discovering that a registered representative maintained a joint brokerage account with a senior investor. FINRA investigated the allegations and took the registered representative's testimony, where the registered representative denied having a joint brokerage account with a customer. FINRA's investigation revealed that the registered representative's testimony was false because he opened the joint brokerage account and accessed the account online numerous times per month. FINRA barred the registered representative from the industry.

Helpline Referrals to Other Regulators

In certain situations where Helpline staff identify potential legal and regulatory violations during discussions with customers that fall outside FINRA's jurisdiction, they also refer matters to other federal, state and local regulators for investigation and potential action.

Referrals to Other Regulators



In situations where Helpline staff have concerns about a senior investor's wellbeing or suspect potential financial or other exploitation, FINRA also reports to and works with the relevant state APS. Since 2015, FINRA has made over 228 referrals to state APS, which have enabled them to investigate and address matters relating to senior investors' financial and physical wellbeing.

Helpline Staff Help Stop $31,000 Forgery and Grand Larceny

A senior investor called the Helpline for assistance regarding an unauthorized joint brokerage account opened for herself, her sister and another relative. According to the senior investor, her sister forged the senior investor's signature, provided the firm a copy of her stolen driver's license, and made an unauthorized transfer of $31,000 to the joint account from the senior investor's individual account. The Helpline staff contacted the member firm and state authorities and, as a result, the senior investor's sister was ultimately arrested and charged with forgery and grand larceny. The firm also returned the $31,000 to the senior investor's account.

Helpline Staff Assist Nassau County District Attorney with Identifying $12 million Ponzi Scheme Targeting Senior Investors

Three senior investors called the Helpline, each stating that a registered representative solicited them to invest $400,000 in purported Certificates of Deposit with interest rates of 4%-6%. FINRA barred the registered representative from the industry and ordered him to pay restitution of $961,781, plus interest.[7] Others involved in the scheme were not subject to FINRA's jurisdiction and the conduct potentially involved criminal activity, so FINRA also referred the matter to the Nassau County District Attorney, which charged the registered representative and an unregistered individual of running a Ponzi scheme that robbed 50 people, mostly senior investors, of more than $10 million and returned $4.6 million to victims.[8]

Collaboration with Other Regulators and Organizations

Helpline staff engage, on an ongoing basis, in a wide range of national and local law enforcement initiatives related to senior investors, including:

- **Transnational Elder Fraud Strike Force**–Worked with Strike Force established by the U.S. Attorney General to bring together joint law enforcement resources and expertise to investigate and prosecute fraud schemes that disproportionately target senior investors.
- **Miami U.S. Attorney's Office Elder Initiative**–Collaborated with representatives from the Federal Bureau of Investigation, Internal Revenue Service, Drug Enforcement Administration, U.S. Department of Housing and Urban Development, the State of Florida and the U.S. Postal Inspection Service.
- **CFPB's Office of Older Americans**–Held joint trainings with this Office, and meets periodically with state securities regulators and states' attorneys general to discuss senior investor protection issues.

Helpline staff based in FINRA's Florida office have hosted outreach and educational events on senior investor issues with the Florida Securities Dealer Association (FSDA), Palm Beach County Estate Planning Council and Florida Attorney General's Special Project "Seniors vs. Crime."

III. FINRA's Broader Commitment to Senior Investors

In addition to the Helpline, FINRA has consistently focused on addressing concerns relating to senior investors. Our efforts have included rulemaking to provide firms with tools to address financial exploitation of seniors, guidance in FINRA publications, reviews of senior investor protection programs in our examinations, enforcement actions and collaboration with other regulators, as well as research and education initiatives.

Rules and Regulatory Framework

In response to growing risks of senior financial exploitation, in 2017, FINRA amended FINRA Rule 4512 (Customer Account Information) and adopted FINRA Rule 2165 (Financial Exploitation of Specified Adults) (collectively referred to herein as the FINRA Senior Exploitation Rules) to create national standards that give member firms tools to address suspected financial exploitation of senior investors and other vulnerable adults.[9] Over the past decade, FINRA issued a number of Regulatory Notices emphasizing firms' obligations to senior investors and providing guidance on how to fulfill those obligations.[10] In addition, FINRA is currently conducting a retrospective review to assess the effectiveness and efficiency of our rules and administrative processes that help protect senior investors from financial exploitation.[11] Section IV of this report provides a comprehensive overview of FINRA Senior Exploitation Rules, as well as our retrospective rule review.

Examination, Oversight and Enforcement

FINRA's Risk Monitoring and Examination Programs have consistently focused on risks relating to senior investors in our reviews of firms' compliance programs. In particular, senior investor issues have been an examination priority in every FINRA annual priorities letter since 2014. As part of firms' exams, FINRA may review how firm controls protect senior investors and assess their compliance with regulatory obligations. Moreover, the fact that FINRA identifies senior investor protection as a priority may help firms concentrate their attention on their policies and procedures relating to senior investors.

Where appropriate, FINRA also brings disciplinary action against firms or registered representatives for misconduct against senior investors.

Collaboration with Other Regulators and Organizations

FINRA works closely with the SEC, the NASAA, state securities regulators, state APS, and the National Adult Protective Services Association (NAPSA) on approaches to senior investor protection. In May 2019, FINRA, the SEC and NASAA issued a Senior Safe Act Fact Sheet designed to raise firms', investment advisers' and transfer agents' awareness about the Act, its immunity provisions and additional resources relating to senior investors. In October 2019, FINRA and state regulators participated in the SEC Roundtable on Combating Elder Investor Fraud, joined the SEC at the Society for Corporate Governance Southeastern Securities Conference, and collaborated with the SEC's Miami office on several outreach events in local communities. In addition, FINRA collaborated with NAPSA to prepare and update the National Guidelines for Financial Institutions: Working Together to Protect Older Persons from Financial Abuse. FINRA also collaborates with state regulators in providing training and addressing potential exploitation of senior and vulnerable adult investors. Moreover, FINRA regularly collaborates with these and other groups on various policy and rulemaking initiatives, as well as investigations and enforcement matters, involving seniors.

FINRA Enforcement Bars Registered Representative Who Cheated Senior Investor Out of $9 million by Churning Account

FINRA barred two registered representatives for their respective roles in churning accounts belonging to a 79-year-old senior investor who suffered from severe cognitive impairment.[12] FINRA found that one of the registered representatives, as the broker of record, used her romantic relationship with the senior investor to exploit him where the two registered representatives effected more than 2,800 trades in his accounts, generating approximately $9 million in commissions from September 2011 through June 2012. FINRA found that over half of these transactions involved short-term trading in long-maturity bonds, including municipal bonds, intended for customers with long-term investment horizons. FINRA also found that one of the registered representatives, who entered most of the day-to-day trades in the senior investor's account, exercised discretion without written authorization.

Buildathon Challenges Firms and Students to Protect Senior Investors

On November 8, 2019, FINRA, Deloitte Touche Tohmatsu Limited (Deloitte) and the MIT Student Fintech Club held a Buildathon—a hackathon-style competition—that challenged teams made up of students and attendees from financial firms to work together to develop solutions that would strengthen investor protection in four areas, including one focusing on senior investors. This senior-related challenge asked teams to develop tools to help firms identify securities that might pose risks to senior investors. The Buildathon was the first event of its kind to bring firm representatives, students and federal and state regulators together to develop technology-based solutions to investor protection challenges.

Research and Education

FINRA and, in particular, the FINRA Investor Education Foundation (FINRA Foundation), are conducting and disseminating research on senior investors and financial fraud[14] and educating consumers about risks facing senior investors,[15] including issues observed by the Helpline staff and other senior investor protection topics included in Appendix 1 to this report.[16]

In addition, we are engaging with national, state and grassroots partners to develop and distribute fraud prevention resources to consumers and providing training for law enforcement professionals, victim advocates and other intermediaries on the front lines fighting financial fraud. For example, since 2012, the FINRA Foundation has partnered with the National White Collar Crime Center to train over 2,150 law enforcement officials representing over 900 federal, state and local agencies in 38 different states on how to detect, prevent and respond to investment fraud. The Foundation regularly invites the SEC and the applicable state securities regulator to participate in these trainings.

Similarly, the FINRA Foundation has collaborated with the National Center for Victims of Crime to train more than 6,200 victim advocates (such as adult protective service workers, social workers and legal aid staff) to better assist individuals who have been victimized by investment and other financial frauds. Through this ongoing partnership, the FINRA Foundation has also distributed nearly 60,000 instructional guides.[17] Over the same period, the FINRA Foundation has conducted outreach to consumers and supported Fraud Fighter Call Centers—operated by the AARP, the FINRA Foundation and the National Telemarketing Victim Call Center—in providing fraud detection and avoidance tips to more than 1.5 million Americans. FINRA also engages with staff of the Senate Special Committee on Aging to share perspectives on scams targeting seniors and potential resources for victims of fraud.

Most recently, in November 2019, FINRA held a Senior Investor Protection Conference to address issues relating to financial exploitation, diminished capacity, suitability, sales practices, scams, legal requirements and regulatory developments with speakers addressing federal, state, industry and medical perspectives. In addition, in October 2019, the FINRA Foundation and the Stanford Center on Longevity co-hosted a conference to share research, information and innovations that could help prevent financial fraud, including emerging neuroscience research on the impact of aging on vulnerability.

IV. FINRA Senior Exploitation Rules

Overview of FINRA Senior Exploitation Rules

The FINRA Senior Exploitation Rules provide firms with the tools to protect senior investors and help firms address risks relating to possible financial exploitation. FINRA Rule 4512 (Customer Account Information) requires firms to make reasonable efforts to obtain the name of and contact information for a trusted contact person upon the opening of a non-institutional customer's account or when updating account information for an existing non-institutional customer account. The trusted contact person is intended to be a resource for the firm in administering the customer's account, protecting assets and responding to possible financial exploitation or diminished capacity. FINRA notes that firms are not prohibited from opening and maintaining an account if customers fail to identify a trusted contact person, as long as they make reasonable efforts to obtain the information.

FINRA Rule 2165 (Financial Exploitation of Specified Adults) permits a firm to place a temporary hold on a disbursement of funds or securities from the account of a "specified adult"[18] customer when the firm reasonably believes that financial exploitation[19] of that adult has occurred, is occurring, has been attempted or will be attempted. In order to support firms' use of such holds to prevent potential financial exploitation, FINRA Rule 2165 provides member firms and their associated persons with a safe harbor from certain other FINRA rules.[20] FINRA also issued *Regulatory Notice* 17-11 (SEC Approves Rules Relating to Financial Exploitation of Seniors) and Frequently Asked Questions Regarding FINRA Rules Relating to Financial Exploitation of Senior Investors to provide additional guidance about these rules and an investor education article to help investors understand the new rules.[21]

Retrospective Review of FINRA Senior Exploitation Rules

In *Regulatory Notice* 19-27 (FINRA Requests Comment on Rules and Issues Relating to Senior Investors), FINRA launched a retrospective review to assess the efficiency and effectiveness of our rules and administrative processes that help protect senior investors from financial exploitation. As part of this review, FINRA is seeking input from both external and internal stakeholders, drawing on the expertise of its advisory committees and other subject-matter experts; and seeking the views and experiences of other stakeholders, including investors, investor advocates, other regulators and regulatory associations, broker-dealer firms, industry associations and the public. Upon completion of this assessment, FINRA will consider next steps, which may include: modifications to existing or proposing new rules, updated or additional guidance, administrative changes or technology improvements, additional tools, educational materials, or additional research or information gathering.

Helpline Helps Enforcement Stop Registered Representative who Stole Approximately $200,000 to Purchase Two New York Apartments in His Name

Helpline staff assisted FINRA Enforcement, which found that the registered representative converted approximately $200,000 from an elderly and legally blind senior investor, coerced him to open a joint account at a non-affiliated bank and used those funds to purchase two apartments in the registered representative's name by taking advantage of the investor's poor eyesight and inability to read documents.[13] The registered representative maintained sole ownership of both apartments, including the investor's primary residence, and even rented the second apartment to tenants and collected and retained the rent. FINRA found that the registered representative violated FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade) and barred him from the industry.

Firm's Temporary Hold Protects Senior Investor from Concerning Investments

The daughter of a senior investor requested a disbursement from her father's account for $35,000 to invest in an offering to build an overseas solar panel energy field and the customer agreed to the disbursement. The firm placed a temporary hold on the disbursement and conducted research and due diligence on the offering, which raised concerns about the legitimacy of the company, the claimed high rate of return and promises to return the customer's investment in 60-90 days. The firm also referred the matter to relevant regulators to further review the offering.

Proposed FINRA Rule to Limit a Registered Person from Being Named a Customer's Beneficiary or Holding a Position of Trust for or on Behalf of a Customer

Although registered representatives often develop close and trusted relationships with their customers, FINRA has observed conflicts of interest and misconduct when customers name such registered representatives as their beneficiaries, executors or trustees, or ask them to hold powers of attorney or similar positions. In particular, FINRA is concerned about registered representatives' serving in such roles for senior investors, who may be particularly vulnerable to financial exploitation.

As a result, *Regulatory Notice* 19-36 (FINRA Requests Comment on a Proposed Rule to Limit a Registered Person from Being Named a Customer's Beneficiary or Holding a Position of Trust for or on Behalf of Customer) proposes new rulemaking to explicitly limit the ability of a registered person to be named to such positions for accounts of non-family-member customers.[22] Proposed new FINRA Rule 3241 (Registered Person Being Named a Customer's Beneficiary or Holding a Position of Trust for a Customer) would require written notice from the registered person followed by the firm's review and assessment of whether to approve, approve with conditions, or disapprove the registered person assuming such status or acting in such capacity, including taking into consideration several factors, such as:

- any potential conflicts of interest in the registered person being named a beneficiary or holding the position of trust;
- length and type of relationship between the customer and registered person;
- customer's age;
- size of any bequest relative to the size of a customer's estate;
- whether, based on the facts and circumstances observed in the member's business relationship with the customer, the customer has a mental or physical impairment that renders the individual unable to protect his or her own interests;
- any indicia of improper activity or conduct with respect to the customer or the customer's account (*e.g.,* excessive trading); and
- any indicia of customer vulnerability or undue influence of the registered person over the customer.

Although the proposed new rule would not *prohibit* a registered person being named a beneficiary of or receiving a bequest from a customer's estate, FINRA would expect firms to employ heightened scrutiny in assessing such requests. The comment period for *Regulatory Notice* 19-36 ended January 10, 2020. Any proposed rule change must be submitted to and approved by the SEC prior to becoming effective.

V. Effective Practices from Firms' Senior Investor Protection Programs

In 2019, FINRA assessed firms' senior investor protection programs, including their implementation of the FINRA Senior Exploitation Rules. In particular, FINRA evaluated how firms addressed risks relating to senior investors in their policies and procedures; gathered trusted contact person information; developed training relating to senior investors; implemented systems to escalate financial exploitation concerns; placed holds on disbursements in customer accounts; conducted senior investor exploitation investigations; and reported instances of financial exploitation.

Senior Investor Compliance Programs

FINRA observed that some firms developed comprehensive senior investor compliance programs—or integrated senior investor-related components into their existing programs—that demonstrated their commitment to the protection of senior investors and their appreciation of the many risks facing these customers:

- **Written Supervisory Procedures**–Firms developed, updated and enforced written supervisory procedures focusing on senior investors, which are required by FINRA Rule 2165(c)(1)-(2) (Financial Exploitation of Specified Adults).[23]
- **Suitability**–Firms considered suitability issues in the context of senior investors, including:
  - Providing disclosure of additional risks or limiting products being marketed to senior investors;
  - Having a clear, up-to-date understanding of investment objectives as a customer nears or begins retirement (*e.g.,* importance of generating income, preserving capital or accumulating assets for heirs);
  - Understanding a senior customer's sources of income (*e.g.,* whether the customer is living on a fixed income or anticipates doing so in the future);
  - Gaining an awareness of how much income a senior customer may need to meet fixed or anticipated expenses;
  - Asking about health care insurance and whether the customer may need to rely on investment assets for anticipated or unanticipated health costs;
  - Addressing additional concerns for senior investors, such as shortened time horizons, potentially decreased risk tolerance and additional significant liquidity needs; and
  - If applicable, considering potential cognitive decline when making recommendations to senior investors, and making additional efforts to explain the features and risks of products.

Helpline Assists Firm With Temporary Hold to Protect Senior Investor from Losing $50,000 to Financial Exploitation from His Brother-in-Law

A brother-in-law of a senior investor called the Helpline, stating that the senior investor's firm had "frozen" the senior investor's account so the senior investor could not get access to $50,000 the senior investor needed for medical treatment. After the Helpline staff contacted the senior investor, he revealed that he needed the $50,000 to pay his brother-in-law a $10,000 per month retainer as his attorney and to invest in a movie deal his brother-in-law found. Helpline staff contacted the firm, which had placed a temporary hold on the disbursements because it was concerned their customer was being financially exploited. Helpline staff then called the state's APS, which conducted a wellness check on the senior investor. Helpline staff referred the matter to the state securities regulator and local criminal authorities.

Firm's Temporary Hold Prevents $200,000 Loss for Senior Investor Involved in a Central Intelligence Agency (CIA) Lawsuit Scam

A customer wanted to withdraw $200,000 from her IRA to cover the upfront fees for a $5.4 million lawsuit she believed she had won. The brokerage firm requested the customer provide the paperwork to verify the lawsuit and the customer stated that it was classified and related to the CIA. The firm indicated the disbursement would account for two-thirds of her assets, placed a temporary hold on the disbursement and contacted APS.

- **Escalation Process**–Firms implemented—and trained registered representatives to use—a comprehensive process to escalate issues relating to senior investors, including but not limited to concerns about financial exploitation, diminished capacity or cognitive decline.
- **Training on Financial Exploitation and Diminished Capacity Red Flags**–Firms developed FINRA Senior Exploitation Rules training[24] for registered representatives via interactive, video-based or in-person sessions, as well as ongoing, regular reminders that included spotting and responding to red flags of financial exploitation, diminished capacity or cognitive impairment in their clients.
- **Senior Investor Team**–Firms created a dedicated senior investor team or, in smaller firms, dedicated staff in Compliance or Legal departments, to:
  - Develop expertise on senior investor issues;
  - Draft desktop procedures regarding the processes of the group;
  - Facilitate broad training as well, as training tailored to specific groups that are likely to encounter red flags of financial exploitation or diminished capacity;
  - Send periodic reminders to key staff about red flags and escalation requirements;
  - Track federal and state requirements relating to senior exploitation, such as state laws that mandate reporting of potential exploitation and address holds on disbursements and transactions;
  - Serve as an escalation point for senior investor-related inquiries from registered representatives and others;
  - Conduct due diligence on situations where there may be suspected financial exploitation of senior investors;
  - Determine whether to place holds on disbursements or transactions, and track those holds;
  - Make resources available to firm customers and associated persons;
  - Engage interdisciplinary experts—such as social workers—to assist Legal and Compliance staff focusing on senior financial exploitation;
  - Report cases of potential senior investor financial exploitation to the relevant state APS, law enforcement, state securities regulators or other agencies; and
  - File Suspicious Activity Reports.

- **FinTech Tools**–Firms supported senior investors' use of vendor tools that:
  - Highlight potential instances where a senior investor is at risk for poor financial decision-making or exploitation, and facilitate collaboration on financial decisions with trusted individuals; and
  - Monitor alerts relating to any concerning or inconsistent financial activity, contact trusted individuals and assist with remediation efforts.

  Senior investors used fintech tools that help them manage their cash flow and other financial responsibilities, including pre-paid debit or credit cards where purchases can be monitored by trusted individuals and bill pay services to help them pay their bills on time.
- **Recognition for Superior Service to Senior Investors**–Firms implemented programs to recognize—through internal awards, articles or other publications—registered representatives who successfully leverage firm resources to protect senior investors, especially those who go above and beyond to take care of senior investors.

Firm's Temporary Hold Prevents Senior Investor from Losing Almost $10,000 in Lottery Scam

A customer contacted his firm because he believed he had won $1.5 million in a Las Vegas lottery. The scammers had convinced the senior that he would need to pay a special tax in advance in order to get his funds. The scammers further told the customer that Ohio, the state where he lived, had a grant available that would pay the majority of the upfront tax, so he only needed to pay $3,300. In further discussion with the customer, the firm learned that he had already paid over $6,000 to try to receive his winnings, using funds held at an account outside the firm. When the firm questioned the customer about having to "pay the tax" twice, the customer indicated the first place lottery winner did not claim their prize and he by default won both. The customer also instructed the firm not to tell his wife, as he wanted to surprise her with the lottery winnings. The firm placed a temporary hold on the disbursement and contacted APS, state regulators and law enforcement.

Firm's Temporary Hold Helps Senior Investor Avoid $60,000 Romance Scam

A customer requested a $60,000 disbursement to an account in a different state to pay for the release of a General arrested in Afghanistan. The firm learned that this transfer was connected with the customer's romantic relationship with someone on an online dating site, and she had previously sent money from an account outside the firm. The firm placed a temporary hold on the disbursement and contacted APS and local law enforcement.

Implementation of the FINRA Senior Exploitation Rules

Some firms developed a number of effective practices to address the FINRA Senior Exploitation Rules:

- **Engaging Customers**–Firms trained registered representatives on how to discuss and request trusted contact person information for all non-institutional customers—not just senior investors[25]—and addressed customers' concerns about firms' maintaining privacy of their financial information from potential trusted contact persons by using new account forms, supplemental forms, scripts and pop-up screens that guide registered representatives' conversations with customers.
- **Removing Trusted Contact Persons**–Firms advised registered representatives that they should not reach out to trusted contact persons who have been removed by the customer or those that the registered representative reasonably believes may be engaging in financial exploitation of the customer.
- **Updating Trusted Contact Persons**–Firms developed comprehensive policies and procedures for updating their customers' trusted contact person[26] and updated their forms or included a separate form as part of their annual account verification or confirmation process.
- **Guidance and Permissions**–Firms provided guidance to registered representatives regarding contacting trusted contact persons when placing a temporary hold[27] and added provisions to client agreements to permit firms to contact trusted contact persons and put temporary holds on disbursements.[28]
- **Account Monitoring**–Firms leveraged advanced technologies to detect, prevent and predict potential diminished capacity or financial exploitation in senior investor accounts, including specialized senior investor-focused or existing fraud detection, anti-money laundering or Bank Secrecy Act account monitoring, surveillance reviews and exception reports, including but not limited to, those that focused on:
  - Transaction types that are inconsistent with prior account activity, such as wiring money out of an account or not paying regular bills;
  - Decreasing account balances; and
  - Access failures or access for new individuals or from new locations.

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The Helpline's work, regulatory initiatives, firm compliance programs and senior investor stories described in this report demonstrate the significance of protecting senior investors to the securities industry. FINRA remains committed to addressing risks relating to financial exploitation and providing relevant resources–such as this report–to firms and senior investors.

Appendix – Senior Investor Protection Resources

FINRA Resources

- Senior Investors Topic Page
- FINRA Securities Helpline for Seniors
- *Regulatory Notice* 19-36 (FINRA Requests Comment on a Proposed Rule to Limit a Registered Person from Being Named a Customer's Beneficiary of Holding a Position of Trust for or on Behalf of Customer)
- *Regulatory Notice* 19-27 (FINRA Requests Comment on Rules and Issues Relating to Senior Investors)
- *Regulatory Notice* 17-11 (SEC Approves Rules Relating to Financial Exploitation of Seniors
- Protecting Seniors From Financial Exploitation (April 25, 2018)
- NASAA-SEC-FINRA Senior Safe Act Fact Sheet (May 23, 2019)
- FINRA and SEC Office of Investor Education and Advocacy, Please Consider Adding a Trusted Contact to Your Account (March 4, 2020)
- Report on the FINRA Securities Helpline for Seniors (December 2015)

SEC Resources

- SEC's Seniors Topic Page
- SEC's Investor.gov Seniors Topic Page
- SEC Division of Investment Management, Response of the Chief Counsel's Office to the Investment Company Institute (June 1, 2018)
- SEC Office of the Investor Advocate, How the SEC Works to Protect Senior Investors (May 2019)
- Interagency Guidance on Privacy Laws and Reporting Financial Abuse of Older Adults
- Investor Alerts
  - Help for Adult Protecting Services (APS) Workers Encountering Senior Investor Fraud (May 9, 2017)
  - How to Avoid Fraud
  - Don't Invite Investment Scams to Find You (Sept. 28, 2018)
  - Ponzi Schemes Targeting Seniors (April 9, 2018)
- Brochures
  - Guide for Seniors: Protect Yourself Against Investment Fraud
  - Stopping Affinity Fraud in Your Community

NASAA Resources

- Serve Our Seniors Webpage
- NASAA Guide for Developing Practices and Procedures for Protecting Senior Investors and Vulnerable Adults from Financial Exploitation (September 2016)
- NASAA Model Act to Protect Vulnerable Adults from Financial Exploitation

Financial Crimes Enforcement Network Resources (FinCEN)

- Advisory to Financial Institutions on Filing Suspicious Activity Reports Regarding Elder Financial Exploitation (February 2011)
- FinCEN Advisory Warns of Elder Financial Exploitation (February 2011)
- Memorandum on Financial Institution and Law Enforcement Efforts to Combat Elder Financial Exploitation (August 2017)

Consumer Financial Protection Bureau Resources

- Reporting of Suspected Elder Financial Exploitation by Financial Institutions (July 2019)
- Suspicious Activity Reports on Elder Financial Exploitation: Issues and Trends (February 2019)
- Recommendations and Report for Financial Institutions on Preventing and Responding to Elder Financial Exploitation (March 2016)

Endnotes

1. An average of 10,000 Americans turn 65 every day and this pace is expected to continue through 2030 when one in every five people in the U.S. will be 65 or older. *See* U.S. Census Bureau, Older People Projected to Outnumber Children for First Time in U.S. History (Mar. 13, 2018).
2. *See, e.g.,* Consumer Financial Protection Bureau, Office of Financial Protection for Older Americans, Suspicious Activity Reports on Elder Financial Exploitation: Issues and Trends (Feb. 2019) (highlighting that SAR filings on elder financial exploitation quadrupled from 2013 to 2017). *See also* U.S. Securities and Exchange Commission, Office of the Investor Advocate, Elder Financial Exploitation (June 2018) (providing an overview of studies on the prevalence of senior financial exploitation).
3. *See, e.g.,* U.S. Securities and Exchange Commission, Office of the Investor Advocate and International Organization of Securities Commissions (IOSCO) Senior Investor Vulnerability Final Report (March 2018) (noting that social isolation and cognitive decline, among other factors, may make some senior investors more vulnerable to financial exploitation).
4. *See* FINRA's 2015 Report on the FINRA Securities Helpline for Seniors.
5. All Helpline data provided in this report is as of December 31, 2019.
6. *See* Matthew C. Mazcko, Letter of Acceptance, Waiver and Consent, Case ID 1888519 (Feb. 9, 2017).
7. *See* Matthew Evan Eckstein, FINRA Office of Hearing Officers, Disciplinary Proceeding No. 2017054146302 (Aug. 28, 2018).
8. *See* Nassau County District Attorney, $10 Million Ponzi Scheme Unraveled Following NCDA Investigation (Sept. 18, 2018); Nassau County District Attorney, NCDA Returns $4.6 Million to Ponzi Scheme Victims Following Prosecutions (Oct. 29, 2019).
9. *See* Regulatory Notice 17-11 (SEC Approves Rules Relating to Financial Exploitation of Seniors).
10. *See, e.g., Regulatory Notice* 07-43 (FINRA Reminds Firms of Their Obligations Relating to Senior investors and Highlights Industry Practices to Serve These Customers); *Regulatory Notice* 09-42 (FINRA Reminds Firms of Their Obligations With Variable Life Settlement Activities); *Regulatory Notice* 11-52 (FINRA Reminds Firms of Their Obligations Regarding the Supervision of Registered Persons Using Senior Designations); *Regulatory Notice* 16-12 (FINRA Provides Guidance on Firm Responsibilities for Sales of Pension Income Stream Products); and *Regulatory Notice* 17-11 (SEC Approves Rules Relating to Financial Exploitation of Seniors).
11. *See Regulatory Notice* 19-27 (FINRA Requests Comment on Rules and Issues Relating to Senior Investors).
12. *See* Ami Kathryn Forte and Charles Joseph Lawrence, Order Accepting Offer of Settlement, Case ID 2016049321302 (Oct. 21, 2019).
13. *See* Jaime R. Rodriguez, Letter of Acceptance, Waiver and Consent, Case ID 2016051772601 (Aug. 28, 2017).
14. *See, e.g.,* The State of U.S. Financial Capability: The 2018 National Financial Capability Study; Exposed to Scams: What Separated Victims from Non-Victims?; Financial Fraud and Fraud Susceptibility In The United States.
15. *See, e.g.,* resources on the FINRA Senior Investors Topic Page; articles such as Protecting Seniors from Financial Exploitation; and investor alerts such as Seniors Beware: What You Should Know About Life Settlements.
16. *See, e.g.,* investor alerts on order types, transfer on death accounts, binary options and related scams, required minimum distributions and powers of attorney.
17. *See, e.g.,* Taking Action: An Advocate's Guide to Assisting Victims of Financial Fraud.
18. *See* FINRA Rule 2165(a)(1) (Financial Exploitation of Specified Adults) defines "specified adult" as "(A) a natural person age 65 and older; or (B) a natural person age 18 and older who the member reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests." FINRA Rule 2165.03 provides that "[a firm's] reasonable belief that a natural person age 18 and older has a mental or physical impairment that renders the individual unable to protect his or her own interests may be based on the facts and circumstances observed in the [firm's] business relationship with the natural person."
19. FINRA Rule 2165(a)(4) defines "financial exploitation" as "(A) the wrongful or unauthorized taking, withholding, appropriation, or use of a Specified Adult's funds or securities; or (B) any act or omission by a person, including through the use of a power of attorney, guardianship, or any other authority regarding a Specified Adult, to: (i) obtain control, through deception, intimidation or undue influence, over the Specified Adult's money, assets or property; or (ii) convert the Specified Adult's money, assets or property."
20. FINRA Rule 2165 (Financial Exploitation of Specified Adults) provides a safe harbor from FINRA Rules 2010 (Standards of Commercial Honor and Principles of Trade), 2150 (Improper Use of Customers' Securities or Funds; Prohibition Against Guarantees and Sharing in Accounts) and 11870 (Customer Account Transfer Contracts).
21. *See* Protecting Seniors from Financial Exploitation (Apr. 25, 2018).
22. The proposed rule would not apply where the customer is a member of the registered person's "immediate family." *See* proposed FINRA Rule 3241(c); *Regulatory Notice* 19-36 (FINRA Requests Comment on a Proposed Rule to Limit a Registered Person from Being Named a Customer's Beneficiary of Holding a Position of Trust for or on Behalf of Customer).

23. FINRA Rule 2165(c)(1) (Financial Exploitation of Specified Adults) requires firms that intend to rely on the rule to "establish and maintain written supervisory procedures reasonably designed to achieve compliance with this Rule, including, but not limited to, procedures related to the identification, escalation and reporting of matters related to the financial exploitation of Specified Adults." In addition, FINRA Rule 2165(c)(2) (Financial Exploitation of Specified Adults) requires firms' written supervisory procedures to "identify the title of each person authorized to place, terminate or extend a temporary hold on behalf of the member pursuant to this Rule" where such person "shall be an associated person of the [firm] who serves in a supervisory, compliance or legal capacity for the [firm]."

24. Some firms did not develop training programs addressing the requirements of the FINRA Senior Exploitation Rules. The safe harbor provided by FINRA Rule 2165 (Financial Exploitation of Specified Adults) requires that they "develop and document training policies or programs reasonably designed to ensure that associated persons comply with the requirements of this Rule." See Supplementary Material .02 of FINRA Rule 2165 (Financial Exploitation of Specified Adults).

25. FINRA Rule 4512 (Customer Account Information) Supplementary Material .06 applies to all non-institutional customers regardless of age.

26. FINRA Rule 4512 (Customer Account Information) Supplementary Material .06(c) requires firms, for all accounts subject to the requirements of Exchange Act Rule 17a-3(a)(17), to "make reasonable efforts to obtain or, if previously obtained, to update where appropriate the name of and contact information for a trusted contact person consistent with the requirements of [Exchange Act] Rule 17a-3(a)(17)."

27. FINRA Rule 2165(b)(1)(B) (Financial Exploitation of Specified Adults) requires that the firm "not later than two business days after the date that the [firm] first placed the temporary hold on the disbursement of funds or securities, provides notification orally or in writing, which may be electronic, of the temporary hold and the reason for the temporary hold to: ... (ii) the Trusted Contact Person(s), unless the Trusted Contact Person is unavailable or the member reasonably believes that the Trusted Contact Person(s) has engaged, is engaged, or will engage in the financial exploitation of the Specified Adult..." (emphasis added)

28. FINRA Rule 2165(b)(1)(C) (Financial Exploitation of Specified Adults) requires that the firm "immediately initiates an internal review of the facts and circumstances that caused the member to reasonably believe that the financial exploitation of the Specified Adult has occurred, is occurring, has been attempted, or will be attempted." (emphasis added)

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Frequently Asked Questions Regarding FINRA Rules Relating to Financial Exploitation of Senior Investors

In February 2017, the SEC approved: (1) the adoption of new FINRA Rule 2165 (Financial Exploitation of Specified Adults) to permit members to place temporary holds on disbursements of funds or securities from the accounts of specified customers where there is a reasonable belief of financial exploitation of these customers; and (2) amendments to FINRA Rule 4512 (Customer Account Information) to require members to make reasonable efforts to obtain the name of and contact information for a trusted contact person ("trusted contact") for a customer's account.[1] New Rule 2165 and the amendments to Rule 4512 became effective February 5, 2018.[2]

Placement of Temporary Holds

Q.1.1. May a member place a temporary hold on a securities transaction pursuant to Rule 2165?

No. Rule 2165 provides a safe harbor for a member to place a temporary hold on a disbursement of funds or securities from the account of a specified adult if the member reasonably believes that financial exploitation of the specified adult has occurred, is occurring, has been attempted or will be attempted.

Rule 2165 does not apply to transactions in securities. For example, Rule 2165 would not apply to a customer's order to sell his shares of a stock. However, if a customer requested that the proceeds of a sale of shares of a stock be disbursed out of his account at the member, then Rule 2165 could apply to the disbursement of the proceeds where the customer is a specified adult and there is reasonable belief of financial exploitation.

Q.1.2. Under Rule 2165, may a member that has a reasonable belief of financial exploitation of a Specified Adult regarding a disbursement or disbursements place a temporary hold or restrictions on an entire account if the member permits legitimate disbursements from the account?

FINRA has stated that, where a questionable disbursement involves less than all assets in an account, a member should not place a blanket hold on the entire account. Each disbursement should be analyzed separately. In addition, FINRA noted that where a disbursement at issue involves all of the assets of the account (*e.g.*, an ACATS transfer request), the member must permit disbursements from the account where there is not a reasonable belief of financial exploitation regarding such disbursements (*e.g.*, regular bill payments). FINRA understands that some members intend, for operational reasons, to place a temporary hold or restrictions on an entire account when they have a reasonable belief of financial exploitation regarding a disbursement or disbursements from the account, but also intend to permit legitimate disbursements from the account in these circumstances. FINRA believes that placing a temporary hold or restrictions on an entire account but allowing legitimate disbursements from the account is consistent with Rule 2165 and members may proceed in such a manner as long as they have procedures reasonably designed to permit legitimate disbursements. FINRA emphasizes that a member may not avail itself of the Rule 2165 safe harbor if it blocks disbursements where there is not a reasonable belief of financial exploitation regarding such disbursements.

Q.1.3. Under Rule 2165, may a member that has a reasonable belief of financial exploitation of a Specified Adult place a temporary hold on a disbursement from an account to another account at the member?

Yes. Rule 2165 provides a safe harbor for a member to place a temporary hold on a disbursement of funds or securities from the account of a specified adult where there is a reasonable belief of financial exploitation. Accordingly, a member may place a temporary hold on a request to disburse funds or securities from an account to another account at the member (*e.g.*, where a member receives a request to move funds from a customer's account to his friend's account at the member but the member reasonably believes that the customer is being financially exploited).

Notification of Temporary Holds

Q.2.1. May a member refrain from providing notification of the placement of a temporary hold to a party authorized to transact business on the account or trusted contact person if the member suspects that the party may be engaged in the financial exploitation of the Specified Adult but needs additional time to conduct an investigation?

Yes. Rule 2165(b)(1)(B) requires that a member provide notification of the placement of a temporary hold and the reason for the hold to all parties authorized to transact business on the account and, if available, the trusted contact person, no later than two business days after the date that the member placed the hold. However, a member may refrain from providing notification to an authorized party or the trusted contact person if the member reasonably suspects that the authorized party or trusted contact person, respectively, may be engaged in the financial exploitation of the Specified Adult but needs additional time to conduct an investigation.

If the member's subsequent investigation indicates that the authorized party nor trusted contact person is not engaged in the financial exploitation, the member should provide the notification to the authorized party or the trusted contact person, respectively.

Extensions of Temporary Holds

Q.3.1. May a member extend a temporary hold beyond the period indicated in Rule 2165 if a state agency, such as adult protective services, securities regulator, or other state agency or regulator, asks a member to extend a temporary hold so that it has more time to investigate the matter or does the state agency need to issue a formal order? In addition, would the member need to report the agency's request to FINRA?

Rule 2165 allows a member to extend a temporary hold upon a state agency's request to do so. The state agency would not have to issue a formal order. In addition, Rule 2165 does not require a member to report a state agency's request to FINRA. However, the member would need to maintain a record of the state agency's request.

Trusted Contact

Q.4.1. Who may serve as the trusted contact for an account pursuant to Rule 4512?

The trusted contact is intended to be a resource for the member in administering the customer's account, protecting assets and responding to possible financial exploitation. To this end, Rule 4512(a)(1)(F) requires that the trusted contact be a natural person age 18 or older.[3] FINRA would not expect a member to verify the age of a designated trusted contact. Other than age, Rule 4512 does not restrict any natural persons from being named as trusted contacts. For example, Rule 4512 does not prohibit joint accountholders, trustees, individuals with powers of attorney and other natural persons authorized to transact business on an account from being designated as trusted contacts.

Q.4.2. Does the requirement in Rule 4512(a)(1)(F) to make reasonable efforts to obtain the name and contact information for a trusted contact upon the opening of a non-institutional customer's account or when updating account information for an existing non-institutional account apply to all non-institutional accounts?

Yes. Rule 4512(a)(1)(F) provides that the trusted-contact provision "shall not apply to an institutional account." Accordingly, the trusted-contact provision applies to any account that does not meet the definition of an "institutional account" in Rule 4512(c), including accounts of non-natural persons that do not meet the definition.

Consistent with Supplementary Material .06(b) to Rule 4512, a member may open or maintain an account where a customer, whether a natural person or a non-natural person, does not provide trusted-contact information.

Because the trusted contact is intended to be a resource for the member, Rule 4512 permits contacting the trusted contact and disclosing information about the customer's account beyond Rule 2165 or suspected financial exploitation. Specifically, consistent with Supplementary Material .06(a) to Rule 4512, the member or an associated person is authorized to contact the trusted contact and disclose information about the customer's account to address possible financial exploitation, to confirm the specifics of the customer's current contact information, health status, or the identity of any legal guardian, executor, trustee or holder of a power of attorney, or as otherwise permitted by Rule 2165. As the SEC noted in its approval order, moreover, a member's communications made pursuant to the trusted-contact provision would be consistent with Regulation S-P. Although the trusted-contact provision perhaps is most relevant when dealing with a customer who is a natural person, members may find that trusted contact information also is useful in other contexts, such as when servicing trusts and small businesses.

Nonetheless, FINRA understands that some members have concerns regarding how Rule 4512(a)(1)(F) applies to a non-natural person account with authorized agent(s) on the account. For an account of a non-natural person non-institutional account (*e.g.*, a corporation, partnership or trust that is not an "institutional account" under Rule 4512(c)), a member may treat any authorized agent (*e.g.*, an officer, partner or trustee) on the account as a trusted contact so long as the member provides the customer with the disclosure required by Supplementary Material .06(a) to Rule 4512.

Q.4.3. Does Rule 4512 require that a customer provide the trusted-contact information?

No. Supplementary Material .06(b) to Rule 4512 states that "the absence of the name of or contact information for a trusted contact person shall not prevent a member from opening or maintaining an account for a customer, provided that the member makes reasonable efforts to obtain the name of and contact information for a trusted contact person." Accordingly, a member is required to make reasonable efforts to obtain the trusted contact name and contact information. However, if the customer declines to provide the information or fails to respond to the member's efforts to obtain the information, the member can open or maintain the customer's account. Asking a customer to provide the name and contact information for a trusted contact (*e.g.*, in an account opening form) constitutes reasonable efforts to obtain the information and satisfies the Rule 4512 requirements.

Q.4.4. When is a member required to seek to obtain the trusted-contact information for accounts in existence prior to the effective date of the amendments to Rule 4512 ("existing accounts")? When is a member required to update the trusted-contact information?

Consistent with the current requirements of Rule 4512(b), a member would not need to seek to obtain the trusted-contact information for existing accounts until such time as the member updates the information for the account either in the course of the member's routine and customary business or as otherwise required by applicable laws or rules. Such an update could include, for example, the required periodic update for accounts subject to Rule 17a-3 under the Securities Exchange Act of 1934 (Exchange Act) as stated below or a communication in which the member, for its own business reasons, proactively seeks to update customer account information, whichever is earlier. A member is not required to create a special process for the sole purpose of seeking to collect such information or to attempt to obtain it whenever the member communicates with a customer (*e.g.*, when an individual registered representative updates account information for a single customer account that is not part of a larger firm effort to update such information).

Following the initial effort, Rule 4512 requires members to seek to update the trusted-contact information for those accounts subject to the requirements in Exchange Act Rule 17a-3. Specifically, Supplementary Material .06(c) to Rule 4512 provides that with respect to any account subject to the requirements of Exchange Act Rule 17a-3(a)(17) to periodically update customer records, a member is required to make reasonable efforts to obtain or, if previously obtained, to update where appropriate the name of and contact information for a trusted contact consistent with the requirements in Exchange Act Rule 17a-3(a)(17).

With regard to updating the contact information for other accounts that are not subject to the requirements in Exchange Act Rule 17a-3, a member should consider asking the customer to review and update the name of and contact information for a trusted contact on a periodic basis or when there is a reason to believe that there has been a change in the customer's situation.

As with Q.4.3., asking a customer with an existing account to provide the name and contact information for a trusted contact (*e.g.*, in a periodic update letter for accounts subject to Exchange Act Rule 17a-3) constitutes reasonable efforts to obtain the information and satisfies the Rule 4512 requirements.

Q.4.5. Where a customer has more than one account, may a member seek to obtain the trusted-contact information for the accounts collectively?

Yes. For purposes of Rule 4512, where a customer has more than one account, a member may seek to obtain the trusted contact information for the accounts collectively (*e.g.*, in one update letter for all of the accounts), provided that each of the affected accounts is clearly identified to the customer. Because the trusted-contact requirement applies at the account level, a customer with more than one account may provide a single trusted contact for all accounts or different trusted contacts for different accounts.

Disclosure

Q.5.1. What is a member allowed to disclose to the trusted contact about a customer's account?

Supplementary Material .06(a) to Rule 4512 requires that, at the time of account opening, a member disclose in writing (which may be electronic) to the customer that the member or an associated person is authorized to contact the trusted contact and disclose information about the customer's account to address possible financial exploitation, to confirm the specifics of the customer's current contact information, health status, or the identity of any legal guardian, executor, trustee or holder of a power of attorney, or as otherwise permitted by Rule 2165. Furthermore, the member is required to provide this disclosure in writing, which may be electronic, when initially seeking to update the information for existing accounts pursuant to Rule 4512(b). Members may also choose to provide this disclosure when updating the information for a customer's account in other circumstances (*e.g.*, when updating the information for accounts where the customer previously declined to provide the trusted contact).

Rule 4512 identifies reasonable categories of information that may be discussed with a trusted contact, including information that will assist a member in administering the customer's account. For example, consistent with the disclosure, if a member has been unable to contact a customer after multiple attempts, a member could contact a trusted contact to inquire about the customer's current contact information. A member also could reach out to a trusted contact if it suspects that the customer may be suffering from Alzheimer's disease, dementia or other forms of diminished capacity. A member could contact a trusted contact to address possible financial exploitation of the customer before placing a temporary hold on a disbursement.

In approving the amendments to Rule 4512 and new Rule 2165, the SEC confirmed that a member's disclosures to a trusted contact pursuant to Rules 4512(a)(1)(F) and 2165 would be consistent with Regulation S-P because such disclosures would be made with the customer's consent or authorization, to protect against fraud or unauthorized transactions, or to comply with federal, state, or local laws, rules and other applicable legal requirements. Accordingly, a member's disclosures to a trusted contact consistent with Rules 2165 and 4512 would be permissible under Regulation S-P.

Q.5.2. Does Rule 4512 mandate any particular form of written disclosure?

No. Members have flexibility in choosing which document should include the required disclosure (*e.g.*, in an account application or another customer form) or whether to provide the disclosure in a separate document (*e.g.*, in a separate letter or email to the customer). However, given the privacy considerations, the written disclosure should be drafted so that customers clearly understand that by providing the trusted-contact information they are consenting to the member contacting the trusted contact consistent with the disclosure.[4]

While Rule 4512 does not mandate any particular form of written disclosure, members are required to include in the disclosure the categories of information set forth in Supplementary Material .06(a) to Rule 4512 – that the member or an associated person is authorized to contact the trusted contact and disclose information about the customer's account to address possible financial exploitation, to confirm the specifics of the customer's current contact information, health status, or the identity of any legal guardian, executor, trustee or holder of a power of attorney, or as otherwise permitted by Rule 2165. A member's decision to include additional categories of information in the written disclosure is beyond the scope of Rule 4512 and members should consider the requirements of Regulation S-P.

Information Sharing

Q.6.1. May a member disclose information to another financial institution related to the suspected financial exploitation of a Specified Adult?

In many instances, a member would be permitted to disclose information to another financial institution related to the suspected financial exploitation of a Specified Adult. Regulation S-P allows a member to share nonpublic personal information with non-affiliated third parties for certain purposes, including to protect against or prevent actual or potential fraud, unauthorized transactions, claims, or other liability.[5] In addition, Section 314(b) of the USA PATRIOT Act permits a financial institution, upon providing notice to the United States Department of the Treasury, to share information with other financial institutions in order to identify and report to the federal government activities that may involve money laundering or terrorist activity.[6]

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1. *See* Securities Exchange Act Release No. 79964 (Feb. 3, 2017), 82 FR 10059 (Feb. 9, 2017) (Notice of Filing of Partial Amendment No. 1 and Order Granting Accelerated Approval of File No. SR-FINRA-2016-039).

2. *See* Regulatory Notice 17-11 (March 2017).

3. A customer, for example, could designate as a trusted contact a lawyer who is 18 years or older and who is associated with a law firm, but could not designate the law firm as a trusted contact.

4. To aid members in complying with the amendments to Rule 4512 and new Rule 2165, FINRA has posted on its website revised versions of the New Account Application Template that include an example of the disclosure. The Template is a voluntary model brokerage account form that is provided as a resource to members when they design or update their new account forms. *See* http://www.finra.org/industry/new-account-application-template.

5. *See* exception provided by 17 CFR § 248.15(a)(2)(ii) and other exceptions to Regulation S-P's notice and opt out requirements provided by §§ 248.14 and 248.15. Member firms are reminded that nonpublic personal information received or disclosed for the purpose of protecting against or preventing actual or potential fraud under 17 CFR § 248.15(a)(2)(ii) or another exception in § 248.14 or 248.15 is subject to 17 CFR § 248.11's limits on redisclosure and reuse for information. In determining whether to share information with another financial institution pursuant to 17 CFR § 248.15(a)(2)(ii) or another exception in § 248.14 or 248.15, a member firm should take appropriate steps to ensure that the financial institution seeking the information is not attempting to obtain customer information fraudulently (*e.g.*, a fraudster impersonating bank staff) and that the information is shared consistent with the member firm's policies and procedures related to Regulation S-P and Regulation S-ID (17 CFR § 248.201).

6. *See* 31 CFR § 1010.540 (Voluntary information sharing among financial institutions); the United States Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN") SAR Activity Review Issue 23 (Apr. 30, 2013) (providing examples of information sharing among financial institutions pursuant to Section 314(b), including for suspected financial exploitation of a senior); and additional information from FinCEN available at https://www.fincen.gov/section-314b. *See also* 31 CFR § 1023.320(e) (Reports by brokers or dealers in securities of suspicious transactions) regarding the requirement to maintain the confidentiality of suspicious activity reports.

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Modified Award
FINRA Office of Dispute Resolution

In the Matter of the Arbitration Between:

Claimants
Rohit Saroop
Preya Saroop
George Sofis

Case Number: 15-03035

vs.

Respondent
Interactive Brokers LLC

Hearing Site: Richmond, Virginia

Nature of the Dispute: Customers vs. Member

This case was decided by an all-public panel.

REPRESENTATION OF PARTIES

For Claimants Rohit Saroop, Preya Saroop, and George Sofis: David Miller, Esq., Shepherd, Smith, Edwards & Kantas LLP, Houston, Texas.

For Respondent Interactive Brokers LLC: David Luger Esq., David Luger Esq., and Hannah O. Koesterer, Esq., Katten Muchin Rosenman, LLP, Chicago, IL. Previously represented by Cameron Stout, Esq., Wiand Guerra King P.A., Palo Alto, California.

CASE INFORMATION

Statement of Claim filed on or about: November 10, 2015.
Preya Saroop signed the Submission Agreement: November 6, 2015.
Rohit Saroop signed the Submission Agreement: November 6, 2015.
George Sofis signed the Submission Agreement: November 6, 2015.

Statement of Answer and Counterclaim filed by Respondent on or about: January 4, 2016.
Respondent signed the Submission Agreement: January 4, 2016.

CASE SUMMARY

Claimants asserted the following causes of action: breach of contract and promissory estoppel, violation of state securities statutes, declaratory judgment, commercially unreasonable disposition of collateral, vicarious liability, and common law fraud. The causes of action relate to unspecified securities.

Unless specifically admitted in the Statement of Answer, Respondent denied the allegations made in the Statement of Claim and asserted various affirmative defenses.

In its Counterclaim, Respondent asserted the following causes of action: failure to mitigate and pay a debt.

RELIEF REQUESTED

In the Statement of Claim, Claimants requested compensatory damages between $1,000,000.00 and $3,000,000.00, direct or consequential damages, market adjusted damages and/or punitive damages, interest, lost opportunity damages, rescission, statutory damages, costs, legal fees, and any and all other relief available

At the close of the hearing, Claimants requested compensatory damages in the amount of $427,556.10 for losses accrued on the account and/or, $1,276.049.90 for losses accrued since ETNs trades using a portfolio margin, and/or $1,660,282.70 for the highest intermediate value of the account.

In its Answer and Counterclaim, Respondent requested dismissal of the Statement of Claim, compensatory damages in the amount of $220,172.09 from Claimants Rohit and Preya Saroop, compensatory damages in the amount of $166,087.53 owed by Claimant Dr. Sofis, interest, costs, and attorneys' fees.

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OTHER ISSUES CONSIDERED AND DECIDED

The Arbitrators acknowledge that they have each read the pleadings and other materials filed by the parties.

At the close of the hearings, Claimants dropped their claim for allowing a non-registered broker to make trades.

On or about February 8, 2017, Respondent filed a Motion to Vacate the Award in the underlying matter. On or about March 6, 2017, Claimants filed an Opposition and Motion to Confirm the Award. Respondent filed a Motion for Summary Judgement dated April 3, 2017. Claimants filed their Reply in Support of Motion to Confirm and Reply in Opposition to the Motion for Summary Judgment dated April 19, 2017. By Order dated September 1, 2017, the Court ordered the matter be remanded back to the Panel for clarification of the damages awarded. After due consideration, the Panel submits this Modified Award.

The parties have agreed that the Award in this matter may be executed in counterpart copies or that a handwritten, signed Award may be entered.

ARBITRATOR'S REPORT

The Claimants are awarded the value of their accounts on August 19, 2015 ($520,450.40 to the Saroops and $500,529.48 to Sofis). Respondent's Counterclaim was dismissed based on Respondent's violation of FINRA Rule 4210 as further explained in FINRA Regulatory Notice 08-09. The securities placed in the portfolio margin account were not eligible for that account based on these rules and regulations. Respondent's position that the Panel should not enforce a FINRA rule amounts to saying that FINRA should provide an opportunity for investors to commit financial suicide by investing in securities that are ineligible for inclusion in a portfolio margin account. To ignore a FINRA rule by the Panel would defeat the purpose of FINRA.

AWARD

After considering the pleadings, the testimony and evidence presented at the hearing, and the post-hearing submissions, the Panel has decided in full and final resolution of the issues submitted for determination as follows:

1. Respondent is liable for and shall pay to Claimants Rohit and Preya Saroop compensatory damages in the amount of $520,450.40 plus interest at the rate of 8% per annum from 30 days of the date of the award until payment.

2. Respondent is liable for and shall pay to Claimants Rohit and Preya Saroop attorneys' fees representing 40% of the compensatory damages and 30% of the net claimed by Respondent for a total of $274,006.16. The Panel granted attorneys' fees pursuant to the parties' agreement.

3. Respondent is liable for and shall pay to Claimant George Sofis compensatory damages in the amount of $500,529.48 plus interest at the rate of 8% per annum from 30 days of the date of the award until payment.

4. Respondent is liable for and shall pay to Claimant George Sofis attorneys' fees representing 40% of the compensatory damages and 30% of the net claimed by Respondent for a total of $249,858.49. The Panel granted attorneys' fees pursuant to the parties' agreement.

5. There was no evidence of profits or losses in securities ineligible for portfolio management accounts from the time that the parties signed the portfolio management agreements and the parties' accounts' net asset values, all cash on August 19, 2015. Therefore, the panel could not consider what happened prior to the investment of cash on August 19, 2015 in the portfolio management accounts.

   The damages set forth above stem from the amounts, all cash, on August 19, 2015, which were subsequently invested in securities that were ineligible for investment in portfolio margin accounts. Values were determined from Claimants' Exhibits 70 and 71 and Respondent's Exhibits R-48 and R115.

Counsel fees were based on an agreement between the attorneys for both parties. There was a dispute as to whether the agreement was cancelled. The Panel found for the Claimants. The amounts were based on a written fee agreement between the counsel and each party. Percentages and fees were obtained from Claimants' Exhibits 53 and 63 and Respondent's Exhibit R-49.

6. Claimants' claim for witness fees is denied.

7. Respondent is liable for and shall pay to Claimants $600.00 as reimbursement of the non-refundable portion of the filing fee previously paid.

8. Respondent's Counterclaims are denied in their entirety.

9. Respondent's request for attorneys' fees is denied.

10. Any and all claims for relief not specifically addressed herein, including punitive damages, are denied.

FEES

Pursuant to the Code, the following fees are assessed:

Filing Fees
FINRA Office of Dispute Resolution assessed a filing fee* for each claim:

Initial Claim Filing Fee	=$ 2,000.00
Counterclaim Filing Fee	=$ 2,125.00

**The filing fee is made up of a non-refundable and a refundable portion.*

As stated in the Award section above, Respondent is liable for and shall pay Claimants $600.00 as reimbursement of the non-refundable portion of the filing fee previously paid.

Member Fees
Member fees are assessed to each member firm that is a party in these proceedings or to the member firm that employed the associated person at the time of the event giving rise to the dispute. Accordingly, as a party, Interactive Brokers, LLC is assessed the following:

Member Surcharge	=$ 3,025.00
Member Process Fee	=$ 6,175.00

Hearing Session Fees and Assessments

The Panel has assessed hearing session fees for each session conducted. A session is any meeting between the parties and the arbitrators, including a pre-hearing conference with the arbitrators, that lasts four (4) hours or less. Fees associated with these proceedings are:

One (1) pre-hearing session with a single arbitrator @ $450.00/session			=$ 450.00
Pre-hearing conference:	October 5, 2016	1 session	
One (1) pre-hearing session with the Panel @ $1,400.00/session			=$ 1,400.00
Pre-hearing conference:	March 28, 2016	1 session	
Nine (9) hearing sessions @ $ 1,400/session			=$ 12,600.00
Hearing Dates:	December 5, 2016	2 sessions	
	December 6, 2016	2 sessions	
	December 7, 2016	2 sessions	
	December 8, 2016	2 sessions	
	December 9, 2016	1 session	
Total Hearing Session Fees			=$ 14,450.00

The Panel has assessed the $14,450.00 hearing session fees to Respondent.

All balances are payable to FINRA Office of Dispute Resolution and are due upon receipt.

ARBITRATION PANEL

Edward Blumstein	-	Public Arbitrator, Presiding Chairperson
Carol A. Schuyler	-	Public Arbitrator
Simon Jonathan Lawrence	-	Public Arbitrator

I, the undersigned Arbitrator, do hereby affirm that I am the individual described herein and who executed this instrument which is my award.

Concurring Arbitrators' Signatures



Edward Blumstein
Public Arbitrator, Presiding Chairperson

1/18/18
Signature Date

Carol A. Schuyler
Public Arbitrator

Signature Date

Simon Jonathan Lawrence
Public Arbitrator

Signature Date

January 30, 2018
Date of Service (For FINRA Office of Dispute Resolution office use only)

ARBITRATION PANEL

Edward Blumstein	-	Public Arbitrator, Presiding Chairperson
Carol A. Schuyler	-	Public Arbitrator
Simon Jonathan Lawrence	-	Public Arbitrator

I, the undersigned Arbitrator, do hereby affirm that I am the individual described herein and who executed this instrument which is my award.

Concurring Arbitrators' Signatures

Edward Blumstein
Public Arbitrator, Presiding Chairperson

Signature Date

Carol A. Schuyler
Public Arbitrator

1/19/18
Signature Date

Simon Jonathan Lawrence
Public Arbitrator

Signature Date

January 30, 2018
Date of Service (For FINRA Office of Dispute Resolution office use only)

ARBITRATION PANEL

Edward Blumstein	-	Public Arbitrator, Presiding Chairperson
Carol A. Schuyler	-	Public Arbitrator
Simon Jonathan Lawrence	-	Public Arbitrator

I, the undersigned Arbitrator, do hereby affirm that I am the individual described herein and who executed this instrument which is my award.

Concurring Arbitrators' Signatures

Edward Blumstein
Public Arbitrator, Presiding Chairperson

Signature Date

Carol A. Schuyler
Public Arbitrator

Signature Date

Simon Jonathan Lawrence
Public Arbitrator

1-24-18
Signature Date

January 30, 2018
Date of Service (For FINRA Office of Dispute Resolution office use only)

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Richmond Division

INTERACTIVE BROKERS LLC, Plaintiff, v. ROHIT SAROOP, PREYA SAROOP, and GEORGE SOFIS, Defendants.	Civil Action No. 3:17-cv-127

PETITION

Plaintiff Interactive Brokers LLC ("Interactive"), by counsel, states as follows for its Petition against Defendants Rohit Saroop, Preya Saroop (collectively, the "Saroops") and George Sofis ("Sofis") (the Saroops and Sofis are referred to collectively as "Speculators"):

Introduction

1. This is a case about stock market speculators – the Saroops and Sofis – who pursued a high risk strategy, made a small fortune, then lost it all when the market finally turned against them, and now want to blame the online broker they used to make their trades. Perhaps, the Saroops and Sofis had a claim against Vikas Brar, the independent "financial advisor" whose strategy led to their wins and losses. But, instead, they came after Interactive, even though the company did not advise them what to do, did not share in their winnings, and should not be made

to bear their losses, especially since there is no contract or recognized cause of action requiring Interactive to do so.

2. The essence of the contracts between Interactive and Speculators was that Interactive was to provide a means by which Speculators could trade in securities using the internet, but that Speculators alone (whether trading directly or through the use of any independent financial advisor they might engage) were to be responsible for any losses arising from their own trading decisions. In short, Interactive did not guarantee the Speculators success, nor did it insure them against failure.

3. The case comes before this Court, pursuant to the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* ("FAA"), as a petition to vacate the arbitration award entered in FINRA Arbitration No. 15-03035 (the "Arbitration Award") against Interactive by a panel composed of three individuals – none from the financial industry – convened under the auspices of the Financial Industry Regulatory Authority (the "Panel" and "FINRA," respectively). This Petition seeks to vacate the Arbitration Award, which was entered on January 10, 2017. A copy of the Arbitration Award is attached as **Exhibit A**.

4. FINRA is a private, self-regulatory organization that sets industry guidelines for its broker-dealer member firms across the country. FINRA also provides an arbitration forum through which disputes between member firms, such as Interactive, and their clients, such as the Saroops and Sofis, can be resolved.

5. Because the transactions between Interactive and Speculators were "transactions involving commerce," 9 U.S.C. § 2, the arbitration agreement between them – as well as the Arbitration Award – are subject to the FAA.

6. The statutory text of the FAA provides grounds on which an arbitration award must be set aside, including "where the arbitrators exceeded their powers.…" 9 U.S.C. § 10(a)(4).

7. Moreover, as explained by the United States Court of Appeals for the Fourth Circuit, the grounds for vacating an arbitration award (whether viewed as common law grounds or as a gloss upon the FAA) include the following:

- Where the "arbitrator's award…violates clearly established public policy…." *Champion Int'l Corp. v. United Paperworkers Int'l Union, Local 507*, 168 F.3d 725, 729 (4th Cir. 1999);
- "[W]here an award fails to draw its essence from the contract…" *MCI Constructors, LLC v. City of Greensboro*, 610 F.3d 849, 857 (4th Cir. 2010); and
- "[Where] the award evidences a manifest disregard of the law." *Id.*

8. Instead of deciding the case in front of them, the Panel members used the arbitration to impose upon Interactive their "own notions of right and wrong," in terms of what obligations brokers ***should*** be made to owe to their clients. *Mountaineer Gas Co. v. Oil, Chem. & Atomic Workers In'l Union*, 76 F.3d 606, 608 (4th Cir. 1996). The Panel did so, for example, by creating causes of action unknown in the law, usurping and rewriting FINRA's enforcement role, and turning on their head Interactive's contracts with Speculators.

9. Interactive asks the Court to vacate the following parts of the Arbitration Award: (a) the award of compensatory damages to Speculators; (b) the dismissal of Interactive's counterclaim, and ancillary dismissal of its attorneys' fee claim; and (c) the award of attorneys' fees to Speculators.

10. Interactive asks the Court to vacate the Panel's award of compensatory damages to Speculators on both statutory grounds and common law grounds recognized by the Fourth Circuit.

11. The award should be vacated on statutory grounds because the Panel exceeded its authority and violated clearly established public policy (a) by creating a cause of action unknown in the law, based on the idea that Interactive allegedly allowed Speculators too much margin, (b) by creating a cause of action unknown in the law, based on FINRA Rule 4210, and/or (c) by acting in contravention to FINRA's policy with respect to Rule 4210.

12. The award should also be vacated on common law grounds because (a) the Panel acted in manifest disregard of the law, by recognizing FINRA's enforcement role (including Rule 4210), then disregarding it, and/or (b) the Panel entered an award of compensatory damages that "failed to draw its essence from the contract" between the parties.

13. Because Speculators put forward another theory for relief, not reached by the Panel, their claim for compensatory damages should be remanded for further proceedings.

14. Interactive asks the Court to vacate that portion of the Arbitration Award that dismissed Interactive's counterclaims and remand those counterclaims for further proceedings. This request for relief is based on the same statutory and common law grounds identified in Paragraphs 11 and 12 with respect to the Panel's award of compensatory damages. At the same time, the Court should also vacate that portion of the Arbitration Award denying Interactive's request for attorneys' fees and remand that issue for further proceedings.

15. Consistent with well-established federal law, on remand of any issues, the case must be heard by a new FINRA panel, not the Panel that rendered the Arbitration Award that is the subject of this Petition.[1]

16. In addition, Interactive asks the Court to vacate the Panel's award of attorneys' fees to Speculators. While the Panel said that the attorneys' fee award was "pursuant to the parties' agreement," there is no provision in the parties' agreements allowing for an award of fees to Speculators. Thus, the award of attorneys' fees must be vacated because:

a. the Panel exceeded its authority when it awarded attorneys fees' to Speculators; and

b. the decision to award attorneys' fees to Speculators "failed to draw its essence from the contract" between the parties.

This portion of the award should be vacated and not remanded. Final judgment should be entered for Interactive.

The Parties

17. Plaintiff Interactive is a limited liability company organized and existing under the law of the State of Connecticut, with its principal place of business in Greenwich, Connecticut. Interactive has two members, neither of which is a citizen of Virginia.

[1] *E.g.*, *McClatchy Newspapers v. Central Valley Typographical Union No. 46*, 686 F.2d 731, 734 (9th Cir. 1982) ("It is [a] fundamental common law principle that once an arbitrator has made and published a final award his authority is exhausted and he is *functus officio* and can do nothing more in regard to the subject matter of the arbitration.") (quoting *La Vale Plaza, Inc. v. R. S. Noonan, Inc.*, 378 F.2d 569, 572 (3d Cir. 1967)); *Muskegon Cent. Dispatch 911 v. Tiburon, Inc.*, 462 Fed. Appx. 517, 527 (6th Cir. 2012) ("where a vacated arbitration award is remanded and requires a reopening of the merits of a claim, remand to a new arbitrator is appropriate").

18. Defendants Rohit Saroop and Preya Saroop are husband and wife. Rohit Saroop works as a marketing strategist for Capital One Bank, and Preya Saroop is an accountant and consultant for Ernst & Young. The Saroops reside in Annandale, Virginia.

19. Defendant George Sofis is a physician. A graduate of Duke University and the Medical University of South Carolina, Sofis resides in Fredericksburg, Virginia.

Jurisdiction and Venue

20. This Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1332, as the parties are citizens of different States and the amount in controversy exceeds $75,000, exclusive of interest and costs.

21. Venue is proper in this judicial district pursuant to the FAA because the Arbitration Award was rendered in this judicial district.

Factual Background

A. Speculators Open Accounts with Interactive.

22. Interactive is an online broker-dealer, similar to Charles Schwab or E-Trade, which provides an internet platform for investors to purchase and sell securities and other products on various exchanges throughout the world. Interactive provides its internet trading services to sophisticated customers and, in some instances, the customers' independent, self-selected financial advisors. Interactive does not employ any traditional "brokers" or financial advisors of its own, and does not provide its customers any investment advice. Because Interactive does not offer trading advice, Interactive is able to offer its services at some of the lowest rates available among online trading firms.

23. The Saroops and Sofis, who are wealthy, sophisticated professionals with significant assets and prior investment experience, opened accounts with Interactive on June 18, 2012, and October 15, 2012, respectively.

24. Speculators hired an independent advisor, Brar Capital LLC and its sole-owner, Vikas Brar (collectively, "Brar"), to act as their financial advisor and trade for them in their accounts. Neither Mr. Brar nor his company has ever been employed by or affiliated with Interactive, nor did Interactive play any role in any of the Speculators' decisions to hire Brar. The Saroops met Mr. Brar through mutual friends, and Sofis met Mr. Brar through a business partner.

25. When they opened their accounts with Interactive Brokers, the Saroops indicated that they had six to ten years of experience trading, and "good" knowledge of, stocks, an annual net income between $250,000 and $500,000, and more than $500,000 in assets.

26. When he opened his account with Interactive Brokers, Sofis indicated that he had six to ten years of stock trading experience, five years of options trading experience, "good" knowledge of stock and options trading, an annual net income between $500,000 and one million dollars, and a net worth between one and five million dollars.

27. When they opened their accounts, the Saroops and Sofis indicated that their objectives were "growth," "speculation" and "hedging." Thus, Speculators apparently agreed to pay Brar (outside of Interactive) a performance fee of 30 percent, annually, against profits, thereby incentivizing speculative investments aimed at high rates of return.

28. When they opened their accounts, Speculators acknowledged the applicability of Interactive's Customer Agreements (**Exhibits B** (Saroop) **and C** (Sofis)), Legal Acknowledgements (**Exhibits D** (Saroop) **and E** (Sofis)), and Interactive's margin trading risk

disclosure, which is modeled on FINRA Rule 2264 (**Exhibit F**). Later, when Speculators sought and received permission to trade using margin in a "portfolio margin" account, they also agreed to Interactive's Portfolio Margin Risk Disclosure Statement (**Exhibits G** (Saroop) **and H** (Sofis)). Those Agreements and Statements included the following key provisions:

a. Speculators represented that their margin and options trading strategies were self-directed and unsolicited, and that they understood the risks associated with them. Ex. G & H, bullets 1-4; Ex. F, bullets 1-4; Ex. B & C ¶ 11(A)-(D);

b. Speculators agreed to monitor their accounts and maintain sufficient equity in those accounts at all times to meet applicable maintenance margin requirements and prevent margin deficiencies. *Id.*

c. As explicitly allowed by FINRA rules, Speculators gave Interactive sole discretion to select and liquidate, without notice to Speculators, some or all account positions if margin requirements were not satisfied and margin deficiencies arose in their accounts. *Id.;* Ex. D & E, bullet 8.

d. Speculators agreed to pay Interactive the full amount of any unsecured trading deficit that remained in their accounts following any margin liquidation. Ex. B & C ¶ 6.

e. Speculators agreed to "reimburse and hold [Interactive] harmless for all actions, omissions, costs, fees (including, but not limited to, attorneys' fees), or liabilities associated with any" default by Speculators. Ex. B & C ¶ 16. In the event of a default by Speculators or in the event of any other dispute between Speculators and Interactive, there was no provision in the parties' contracts that would require Interactive to reimburse Speculators for any of their attorneys' fees.

B. Speculators Employed a Risky Margin Trading Strategy that, for Many Years, Provided Enormous Profits.

29. Sofis opened his account with Interactive in October of 2012 with $100,000. The Saroops opened their account with an initial deposit of $25,000 in June 2012. In 2013, the Saroops deposited an additional $75,000, and in 2014 another $50,000.

30. Speculators closely watched their accounts, logging into them from their computers, interacting with Brar, and receiving quarterly activity statements from Interactive.

31. Relying on their own judgment and/or the judgment of Brar, the Saroops and Sofis pursued a highly risky strategy that combined (a) the sale of "naked short call options," with (b) "margin" trading. These terms require some explanation.

Naked Short Call Options

32. A "call" option is a security in which the seller (here, the Speculators) sells the right to buy some underlying security (such as a stock or, here, an Exchange Traded Note or "ETN") to the purchaser at a predetermined price (called the "strike price") up until a certain future date (called the "expiration date"). In return for the sale of this right, the buyer pays to the seller an agreed-upon sum of money, which is called a "premium."

33. Of course, as everyone knows, the market prices of securities can – and often do – fluctuate over time. Thus, if the market price of the underlying security goes above the strike price on or before the expiration date, then the option holder can exercise his right and buy the security at the lower-than-market price. The option holder also can sell his option to someone else prior to expiration if there is a willing buyer.

34. If the market price does not go above the strike price by the expiration date, and the option holder has not sold the option to someone else, then the option expires worthless. The "premium" that the seller collected when he sold the option is the seller's profit.

35. Traders who are willing to take the sort of risk that comes from selling call options often guard against out-of-control losses by buying the underlying security or opening some other offsetting position that will limit their exposure. Of course, this sort of hedging limits not only the trader's potential losses, but his potential profits as well. When a trader sells calls without owning the underlying security, it is called a "naked" short call.[2] Trading naked short calls is very risky, especially if the position is not otherwise hedged, because the price of the underlying security can increase considerably. This is what the Saroops and Sofis did: they sold naked calls, and a great many of them, without any kind of hedge.

Operating On Margin

36. To implement their high-risk, high-reward trading strategies, the Saroops and Sofis also elected to trade on "margin" in a "portfolio margin" account.

37. A margin trade is one in which clients essentially use the capital of their broker to take risks, rather than use their own money. The client of the broker makes a security deposit (a "margin deposit") to hold an investment position in the client's account. If the position is profitable, the client will earn greater profits than it otherwise would have. If a margined position is unprofitable, the client can lose more than the amount of money in the account and may end up owing additional money to the broker.

38. If the customer is unable down the road to pay the broker for a margin trade that results in a loss, the ***broker – not the customer*** – is liable to the exchange and to the clearinghouse to pay for the trade (because the customer and the exchange are not in contractual privity).

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[2] The term "short" refers to a position that is opened by ***selling*** a security or product. If a trader opens a position by ***buying*** a security or product, it is known as a "long" position. A "short" position is closed by buying the security or product that was originally sold. Likewise, a "long" position is closed by selling the security or product that was originally bought.

39. To protect brokers from the risk that their customers may not be able to pay for the margin trades that they make, clients with positions held on margin must maintain a minimum amount of margin equity (security deposit) in their brokerage accounts at all times pursuant to FINRA rules and federal law. It is well-established under federal law that FINRA minimum margin requirements and federal margin rules exist to protect ***brokers*** from defaulting clients, not to protect clients from their own bad trading decisions.

40. Throughout the life of the account, the customer must continually maintain a certain value of collateral to satisfy the margin requirement. If the market moves against the customer and the collateral in the account becomes insufficient to satisfy margin requirements, the account is in "margin deficit" or "margin call" status. If the customer does not add cash to the account to prevent or cure a margin deficit, then the broker is authorized to "close" the client's position. In order to close the client's position, the broker liquidates or converts the client's investment positions back to cash by selling them (or buying back positions held "short").

41. Interactive's clients primarily use two types of margin: (i) rule-based Regulation T, or "Reg T," margin, and (ii) risk-based "portfolio margin."

42. Reg T is the Federal Reserve Board regulation governing the amount of credit that a broker may extend to customers who use margin.

43. Portfolio margin accounts are subject to margin requirements arising from a "risk-based" model. This risk-based model is applied each night to U.S. stocks and options by the federally-chartered Options Clearing Corporation ("OCC"). Using a sophisticated algorithm, the OCC takes into account various parameters, such as the historical volatility of each stock and

option, and determines the risk for the various securities. The results are then disseminated to FINRA member firms once per day – each night.

44. A client can choose whether he wishes to trade in a Reg T account or a portfolio margin account (assuming he is eligible and approved for both types of margin accounts). For the time period at issue in the arbitration, Speculators chose to trade in portfolio margin accounts.

45. Not all securities are eligible for portfolio margining. FINRA decides which securities are eligible for portfolio margining.

46. FINRA also determines whether it is a violation of FINRA rules for a broker to allow clients to trade a particular security using portfolio margining. If a security may not be traded using portfolio margining, it may still be placed in a portfolio margin account and traded pursuant to Reg T rules.

47. Under federal and exchange margin rules, as well as Interactive's contracts with the Saroops and Sofis, Interactive had the right (in its sole discretion) to choose how, when and if to liquidate positions in the Saroop and Sofis accounts if the accounts fell into margin deficit (which they did).

48. Having been provided the margin they wanted, in order to make the investments they wanted, Speculators now complain about the consequences of the risks they wanted to take.

How Speculators' Risky Investment Strategy Led to Their Losses.

49. Speculators engaged in risky trading throughout the time that they held accounts with Interactive. By July 2015, their strategy appeared focused on selling "naked calls" on margin on securities known as Exchange Traded Notes or "ETNs."

50. The ETN options traded by the Speculators were options linked to stock market volatility. Specifically, Speculators traded options on a security formally known as the "iPath S&P 500 VIX ST Futures ETN" (commonly known as "VXX ETNs"). This is a security designed to provide investors with exposure to the Chicago Board Options Exchange ("CBOE") Volatility Index (the "VIX," otherwise known as the "fear index"). Generally, when market volatility increases, the value of the VXX ETNs increases; when market volatility is stable, the value of the VXX ETNs is relatively stable.

51. By selling naked call options on VXX ETNs – on margin – the Speculators were betting heavily that the market would remain stable; and, for a while, their strategy worked, leading to financial gains for Speculators.

52. By the close of markets on August 19, 2015, just before the events at issue, Sofis' account was worth $500,529.48, and the Saroops' account was worth $520,450.40. Thus, the total combined value of Speculators' accounts, as a result of their various risky trading strategies, exceeded a million dollars. This represented a *nearly 400 percent return* on Speculators' total deposits of $250,000.

C. In August of 2015, Speculators Engaged in Trades that Increased Their Vulnerability. Then, Market Volatility Rose and Their Positions Were Liquidated.

53. On Thursday, August 20, 2015, Speculators continued their high-risk strategy. Acting through Brar, Speculators sold ***hundreds*** of naked call options on VXX ETNs, and did so on margin.

54. These naked short calls were the *only* non-cash positions in Speculators' accounts at the time the markets closed on Thursday, August 20. Thus, Speculators' entire net account value was bet on their prediction that the market would remain stable, so that the volatility index

(VIX) would not rise, pushing up the market prices of the VXX ETNs on which they had sold so many call options.

55. The obvious danger of this trading strategy was this: if market volatility increased, the market price of the VXX ETNs would also increase, bringing that price closer to the "strike prices" at which the Speculators had sold the call options. As the market price approached the strike prices, the potential for *exceeding* those strike prices would grow, as well, exposing Speculators to huge liabilities.

56. The increased market price of the underlying VXX ETNs would also cause the value of Speculators' accounts to decrease significantly because the call options Speculators sold would become more valuable in the hands of the purchasers. This, in turn, could result in a margin deficiency and trigger a decision by Interactive to start liquidating the Speculators' positions (as its contract with the Speculators permitted Interactive to do) in order to protect itself from possible account deficits.

57. This is exactly what happened. The Speculators' run of good luck, betting everything on a stable market, ran out. On August 20, after the Speculators sold hundreds of calls, market volatility increased as the day wore on (with the VIX increasing by 26 percent). Volatility increased again on Friday, August 21 (with the VIX increasing by another 46 percent).

58. After the markets opened on Monday, August 24, the value of the Speculators' accounts dropped dramatically. The value of the Saroops' account was down to $79,580, and the value of Sofis' account was down to $75,900.

59. These values placed Speculators far below the margin requirements for their accounts and into margin deficiency. Speculators did nothing to cure the deficit, *i.e.*, they did not deposit additional funds as a security deposit as required under their contracts with

Interactive. So, starting about 30 minutes after the markets opened on August 24, Interactive began to liquidate the positions in Speculators' accounts, as expressly permitted by Speculators' account agreements. *See supra* ¶ 28.

60. The margin deficit was significant enough, however, that liquidating all of Speculators' positions did not cure the margin deficits, and Speculators did not have sufficient funds in their accounts even to close all of their positions without leaving a deficit in their accounts. After the liquidations, therefore, account deficits remained in Speculators' accounts. Speculators refused to pay these debts to Interactive and, instead filed their Statement of Claim with FINRA. *See* **Exhibit I.**

61. Interactive responded by denying liability and filing a counterclaim for the deficits remaining in Speculators' accounts. *See* **Exhibit J**.

62. In a nutshell, Speculators made three sorts of claims.

63. First, Speculators alleged that Interactive violated FINRA Rules – specifically, Rule 4210 – by allowing them to trade VXX ETN options on portfolio margin.

64. Contrary to Speculators' allegation, however, FINRA does not consider it a violation of FINRA Rules for brokers to apply portfolio margin requirements to VXX ETNs and their options.

65. It was because of this FINRA-violation claim by Speculators that the Panel awarded Speculators compensatory damages.

66. It was also because of this FINRA-violation claim by Speculators that the Panel struck Interactive's counterclaims.

67. For their second claim, Speculators alleged that Interactive did not carry out the liquidation of their accounts in a commercially reasonable manner. The Panel did not reach this second claim, so it is not the subject of this Petition.

68. This allegation is meritless in any event. The liquidation of Speculators' accounts by Interactive was carried out in full compliance with industry rules and the parties' contracts.

69. For their third claim, the Speculators blamed Interactive for the bad advice they were given by Brar, their independent financial advisor, based primarily on the argument that Interactive was liable for Brar's failure to register as a financial advisor. At the close of the hearing, Speculators dropped this claim. *See* Arbitration Award, at 2.

THE ARBITRATION AWARD AND GROUNDS FOR VACATING THAT AWARD

70. There are three parts of the Arbitration Award that should be vacated, including the award of compensatory damages to the Speculators, the dismissal of Interactive's counterclaim (and ancillary dismissal of Interactive's claim for attorneys' fees), and the award of attorneys' fees to the Speculators. Each of these three parts will be discussed in turn.

I. The Award of Compensatory Damages to the Speculators

71. The Arbitration Award states: "The [Speculators] are awarded the value of their accounts on *August 19, 2015* ($520,450.40 to the Saroops and $500,529.48 to Sofis)." Award, at 3 (emphasis added). August 19, 2015, was the day before the Speculators chose to sell the risky, short call options that eventually led to their losses (and to losses by Interactive).

72. The Award goes on to say that "[t]he securities placed in the portfolio margin accounts were not eligible for that account based on [FINRA Rule 4210 as further explained in regulatory notice 08-09]."

73. The Arbitration Award then says that Interactive "shall pay Speculators Rohit and Preya Saroop compensatory damages in the amount of $520,450.40…." Award, at 3.

74. Similarly, the Arbitration Award says that Interactive "shall pay Claimant George Sofis compensatory damages in the amount of $500,529.48." *Id.*

75. Thus, the award of compensatory damages to the Saroops and Sofis was based on the Panel's view that Interactive allowed Speculators too much margin and/or violated FINRA Rule 4210 by allowing the securities purchased by the Speculators on August 20, 2015, to be placed in their portfolio margin accounts.

A. Grounds for Vacating the Award of Compensatory Damages

76. Interactive restates the allegations in the preceding paragraphs, as if set forth fully herein.

77. There are three grounds (both statutory and common law) for vacating the award of compensatory damages to the Saroops and Sofis, as set forth below.

1. Exceeding Authority/Violating Public Policy

78. It is decidedly the realm of federal and state legislatures to create causes of action not previously known in the law. This is a well-established principle of public policy deeply rooted in the constitutional separation of powers.

79. No private right of action exists for a broker allowing a client too much margin, or for the violation of a broker-dealer regulatory rule. By awarding damages to Speculators based on supposedly allowing Speculators too much margin, and/or a supposed violation of FINRA Rule 4210, the Panel purported to recognize a cause of action where none existed, thereby exceeding its authority – and violating public policy – by usurping the role of the national and state legislatures.

80. In addition, by awarding damages to Speculators based on a supposed violation of FINRA Rule 4210, the Panel acted in contravention to FINRA's policy with respect to Rule 4210, thereby usurping the exclusive role of FINRA.

2. Manifest Disregard of the Law

81. The Panel also acted in manifest disregard of the law.

82. FINRA does not treat the *placing* of ETN options in a portfolio margin account as a violation of Rule 4210 (or any other FINRA rule). FINRA also does not consider a broker's *application* of portfolio margin to ETN options to be a violation of Rule 4210 (or any other FINRA rule).

83. Thus, while the Panel recognized FINRA's enforcement role (including Rule 4210), they nonetheless disregarded it.

3. The Award Failed to Draw Its Essence from the Contracts

84. The essence of the contracts between Interactive and Speculators was that Interactive was to provide a means by which Speculators could trade in securities using the internet, but that Speculators alone (whether trading directly or through the use of any independent financial advisor they might engage) were to be responsible for any losses arising from their own trading decisions. In addition, there is no contractual provision between the parties that states that Interactive can be held liable to Speculators for the alleged violation of any FINRA rule (*e.g.*, FINRA margin rules).

85. By shifting to Interactive the losses that Speculators experienced as the result of their (or their advisor's) own improvident trading strategy, the Panel's award "fails to draw its essence from the contract…" *MCI Constructors, supra*. Likewise, by holding Interactive liable

to Speculators for the alleged violation of a FINRA rule, the Panel's award "fails to draw its essence from the contract…" *Id.*

B. Relief Sought

86. For each of the foregoing reasons (both separately and in combination), that portion of the Arbitration Award granting compensatory damages to Speculators must be vacated.

87. Inasmuch as the Panel did not reach a second theory of liability asserted by Traders (*e.g.,* improper liquidation), the proper remedy is for the Court to remand for consideration of that theory of liability.

88. Any such remand should be to a new FINRA arbitration panel, not the Panel that rendered the Arbitration Award that is the subject of this Petition. *See supra* at n. 1 (citing authority).

II. The Dismissal of Interactive's Counterclaim

89. Interactive restates the allegations in the preceding paragraphs, as if set forth fully herein.

90. The Arbitration Award states: "Respondent's Counterclaim was dismissed based on Respondents violation of FINRA Rule 4210…" Award, at 3.

91. Having ordered this dismissal, the Panel then denied Interactive's request for attorneys' fees. Award, at 3.

A. Grounds for Vacating the Dismissal of Interactive's Counterclaim

92. The Panel's dismissal of Interactive's Counterclaim is the "flip-side" of its award of compensatory damages to Speculators. Being based on the same reasons as that award of

damages, it also must be vacated for the same reasons that the award of damages must be vacated, as further explained below.

1. Exceeding Authority/Violating Public Policy

93. It is decidedly the realm of federal and state legislatures (or, where authorized by statute, a government regulatory agency) to create rules of conduct not previously imposed on individuals and companies, as well as penalties for such violations. This is a well-established principle of public policy deeply rooted in the constitutional separation of powers.

94. By dismissing Interactive's counterclaim, based on supposedly allowing Speculators too much margin, and/or a supposed violation of FINRA Rule 4210, the Panel purported to recognize a rule of conduct and penalty where none existed, thereby exceeding its authority – and violating public policy – by usurping the role of the national and state legislatures (as well as government regulatory agencies).

95. In addition, by dismissing Interactive's counterclaims based on a supposed violation of FINRA Rule 4210, the Panel acted in contravention to FINRA's policy with respect to Rule 4210, thereby usurping the role of FINRA.

2. Manifest Disregard of the Law

96. The Panel also acted in manifest disregard of the law.

97. FINRA does not treat the *placing* of ETN options in a portfolio margin account as a violation of Rule 4210 (or any other FINRA rule). FINRA also does not consider a broker's *application* of portfolio margin to ETN options to be a violation of Rule 4210 (or any other FINRA rule).

98. Thus, while the Panel recognized FINRA's enforcement role (including FINRA Rule 4210), the Panel disregarded it when it dismissed Interactive's counterclaims.

3. The Award Failed to Draw Its Essence from the Contracts

99. The essence of the contracts between Interactive and Speculators was that Interactive was to provide a means by which Speculators could trade in securities using the internet, but that Speculators alone (whether trading directly or through the use of any independent financial advisor they might engage) were to be responsible for any losses arising from their own trading decisions.

100. Thus, the agreements between the parties are clear that Speculators were liable to Interactive for any deficit in their account. In addition, there is no contractual provision between the parties that states that debts owed by Speculators to Interactive are extinguished if Interactive allegedly violates a FINRA rule.

101. By dismissing Interactive's counterclaims for account deficits that arose from the trading losses Speculators experienced as the result of their (or their advisor's) improvident trading strategy, the Panel's award "fails to draw its essence from the contract…." *MCI Constructors, supra*. Thus, the dismissal of the counterclaims must be vacated.

B. Relief Sought

102. For each of the foregoing reasons (both separately and in combination), that portion of the Arbitration Award dismissing Interactive's counterclaims must be vacated and the case remanded for consideration of those counterclaims.

103. As ancillary relief, the Court should vacate and remand that portion of the Arbitration Award denying Interactive's request for attorneys' fees, so that an award of such fees can be considered on remand if Interactive prevails on its counterclaims.

104. The remand should be to a new FINRA arbitration panel, not the Panel that rendered the Arbitration Award that is the subject of this Petition. *See supra* at n. 1 (citing authority).

III. The Award of Attorney Fees to the Saroops and Sofis

105. Interactive restates the allegations in the preceding paragraphs, as if set forth fully herein.

106. For the Saroops, the Arbitration Award states:

> Respondent is liable for and shall pay to [Speculators] Rohit and Preya Saroop attorneys' fees representing 40% of the compensatory damages and 30% of the net claimed by Respondent for a total of $274,006.16. The Panel granted attorneys' fees *pursuant to the parties' agreement*.

Award, at 3 (emphasis added).

107. Similarly, for Sofis, the Arbitration Award states:

> Respondent is liable for and shall pay to Claimant George Sofis attorneys' fees representing 40% of the compensatory damages and 30% of the net claimed by Respondent for a total of $249,858.49. The Panel granted attorneys' fees *pursuant to the parties' agreement.*

Award, at 3 (emphasis added).

A. Grounds for Vacating the Awards of Attorneys Fees.

1. The Award to the Saroops

108. The Panel purported to base its award of attorneys' fees to the Saroops on "the parties' agreement;" however, there is no agreement between Interactive and the Saroops that provided for attorneys' fees to be awarded to the Saroops or that vested the Panel with that authority.

109. A true copy of the account agreement between Interactive and the Saroops is attached as **Exhibit B**. It does not provide for attorneys' fees to be granted to the Saroops.

110. A true copy of the arbitration submission agreement involving Interactive and the Saroops is attached as **Exhibit K**. It does not provide for attorneys' fees to be granted to the Saroops or authorize the Panel to make such an award.

111. Given these facts, the Panel's decision to award attorneys' fees to the Saroops "failed to draw its essence from the contract" between the parties and, thus, must be vacated. *MCI Constructors, supra.*

112. By awarding attorneys' fees to the Saroops, "the arbitrators exceeded their powers…" 9 U.S.C. § 10(a)(4).

2. The Award to Sofis

113. The grounds for vacating the award of attorneys' fees to Sofis parallel the grounds for vacating the award to the Saroops.

114. The Panel purported to base its award of attorneys' fees to Sofis on "the parties' agreement;" however, there is no agreement between Interactive and Sofis that provided for attorneys fees to be granted to Sofis or vested the Panel with that authority.

115. A true copy of the account agreement between Interactive and Sofis is attached as **Exhibit C**. It does not provide for attorneys' fees to be granted to Sofis.

116. A true copy of the arbitration submission involving Interactive and Sofis is attached as **Exhibit K**. It does not provide for attorneys' fees to be granted to Sofis or authorize the Panel to make such an award.

117. Given these facts, the Panel's decision to award attorneys' fees to Sofis "failed to draw its essence from the contract" between the parties and, thus, must be vacated. *MCI Constructors, supra.*

118. By awarding attorneys' fees to Sofis, "the arbitrators exceeded their powers.…" 9 U.S.C. § 10(a)(4).

B. Relief Sought

119. For the foregoing reasons (both separately and in combination), that portion of the Arbitration Award granting attorneys' fees to Speculators must be vacated and final judgment entered for Interactive.

Prayer for Relief

WHEREFORE, Plaintiff Interactive Brokers LLC, prays that this Court grant the following relief:

a. Vacate that portion of the Arbitration Award that awarded compensatory damages to Defendants Rohit Saroop and Preya Saroop, and remand that issue for further arbitration proceedings;

b. Vacate that portion of the Arbitration Award that awarded compensatory damages to Defendant George Sofis, and remand that issue for further arbitration proceedings;

c. Vacate that portion of the Arbitration Award that dismissed Interactive's counterclaim against Defendants Rohit Saroop and Preya Saroop, and remand that issue for further arbitration proceedings;

d. Vacate that portion of the Arbitration Award that dismissed Interactive's counterclaim against Defendant George Sofis, and remand that issue for further arbitration proceedings;

e. Vacate that portion of the Arbitration Award that denied Interactive's request for attorneys' fees against Defendants Rohit Saroop and Preya Saroop, and remand that issue for further arbitration proceedings;

f. Vacate that portion of the Arbitration Award that denied Interactive's request for attorneys' fees against Defendant George Sofis, and remand that issue for further arbitration proceedings;

g. Vacate that portion of the Arbitration Award that awarded attorneys' fees to Defendants Rohit Saroop and Preya Saroop, and dismiss their attorneys' fees claim with prejudice;

h. Vacate that portion of the Arbitration Award that awarded attorneys' fees to Defendant George Sofis, and dismiss his attorneys' fees claim with prejudice;

i. Order that, consistent with the rules of FINRA and the Federal Arbitration Act, the issues remanded for further arbitration proceedings be heard and decided by a new panel (*i.e.* a panel composed of three persons, none of whom served on the panel that entered the Arbitration Award that is the subject of this Petition); and

j. Grant Interactive such other and further relief as the nature of the case may require.

Respectfully submitted,

INTERACTIVE BROKERS, LLC

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Interactive Brokers LLC v. Saroop et al Doc. 95

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IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Richmond Division

INTERACTIVE BROKERS LLC,

Plaintiff,

v. Civil Action No. 3:17-cv-127

ROHIT SAROOP, PREYA SAROOP, and GEORGE SOFIS,

Defendant.

MEMORANDUM OPINION

This matter is before the Court on the PLAINTIFF'S MOTION TO VACATE MODIFIED ARBITRATION AWARD (ECF No. 79) and DEFENDANT'S MOTION TO CONFIRM THE MODIFIED ARBITRATION AWARD (ECF No. 80). For the reasons set forth below, the PLAINTIFF'S MOTION TO VACATE MODIFIED ARBITRATION AWARD (ECF No. 79) will be granted and the DEFENDANT'S MOTION TO CONFIRM THE MODIFIED ARBITRATION AWARD (ECF No. 80) will be denied. Further, the Court will remand the matter to a new panel of arbitrators to consider the Plaintiff's counterclaims.

BACKGROUND

This matter is a familiar one to the Court. In January 2017, a Financial Industry Regulatory Authority ("FINRA") arbitration panel rendered an arbitration award (the "first arbitration decision") in favor of Claimants George Sofis and Rohit and Preya Saroop ("Claimants") and against Interactive Brokers, LLC

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("Interactive") (ECF No. 1-2). Interactive moved to vacate that award (ECF No. 1) and Claimants moved to confirm it (ECF No. 18). Faced with an inscrutable award, this Court remanded the first arbitration decision back to the same panel of arbitrators for clarification.[1] ECF No. 50 (hereinafter, the "Remand Opinion"). Fully aware of the Court's instructions in the Remand Opinion, the arbitrators issued a modified award (the "second arbitration decision") in January 2018, again in favor of the Claimants. ECF No. 71-1. Once again, Interactive moved to vacate the award (ECF No. 79) and Claimants moved to confirm it (ECF No. 80).

A. Factual Background

The factual background is set out fully in the Remand Opinion (ECF No. 50) and is incorporated here.

Interactive is an online brokerage firm that provides a web-based platform for sophisticated investors to purchase and sell securities and other products on various exchanges throughout the world. ECF No. 1 at 6. Interactive offers these services to its customers without any accompanying financial advice. It merely executes the trades that its customers (or its customers' own investment advisors) request. Id. Consequently, Interactive's

[1] Claimants appealed the Court's remand to the Arbitrators (ECF No. 55); the Fourth Circuit dismissed the appeal on the grounds that it was a non-appealable interlocutory order. ECF No. 67.

contracts with its customers include, among other things,[2] waivers of liability for any and all losses sustained through the market. ECF No. 1-3, 1-4. The Claimants in this case were three such customers.

The Saroops opened an account with Interactive on June 18, 2012 with an initial deposit of $25,000. They deposited an additional $75,000 in 2013, and another $50,000 in 2014. Sofis opened his account with Interactive on October 15, 2012 with a deposit of $100,000. Both the Saroops and Sofis hired an independent financial advisor, Vikas Brar of Brar Capital LLC, to run their accounts with Interactive and to make trades on their behalf. The parties appear to agree that neither Brar nor his company has ever been employed by or affiliated with Interactive, and that the decision to hire Brar was made solely by the Claimants themselves.

Over the course of their contractual relationship with Interactive, the Claimants (through Brar) engaged in a high-risk trading strategy that relied on the sale of so called "naked short

[2] Of particular relevance to these proceedings, the contracts also included: (1) a mandatory arbitration provision; (2) a choice of law provision stating that Connecticut law governs contract interpretation; (3) and an attorneys' fee provision that purports to give Interactive (only) the right to fees.

call" options[3] and "margin" trading.[4] These strategies initially resulted in large profits for the Claimants, but that changed in 2015.

On January 15, 2015, at Brar's request, the Saroops converted their account with Interactive from a Regulation T[5] margin account to a portfolio margin account. Sofis did the same in July of 2015. This change in account type allowed Brar to engage in still riskier transactions on behalf of the Claimants: under Regulation T's margin requirements, investors may borrow up to fifty percent of the purchase price of a security using a loan from the broker;

[3] A call option is the option to buy some underlying security (such as the Exchange Traded Notes ("ETNs") at issue in this case) at a predetermined "strike price" up until some future date. If the value of the underlying security never hits the "strike price," the option is worthless and the seller pockets the premium from the sale of the option. Because this is a risky strategy, investors often hedge their position by buying the underlying security involved in the transaction, thereby limiting their risk (and reward). When an investor sells such an option without owning the underlying security (thereby exposing him or herself to higher risk), it is called a "naked" short call.

[4] Essentially, trading on the "margin" refers to a method of buying securities (or stock, etc.) that involves borrowing a part of the sum needed to execute the transaction from the broker himself—here, Brar. Margin trading may result in quicker profits, but it also exposes the investor to the risk of losses in excess of the amount of their initial investment.

[5] 12 C.F.R. § 220.

under Portfolio Margin, investors can (usually) achieve far greater leverage.[6]

By the time the Claimants' accounts were converted to portfolio margin accounts in 2015, Brar was exclusively (or nearly exclusively) relying on a strategy of selling naked call options of iPath S&P 500 VIX Short-Term Futures (VXX), an exchange traded note ("ETN") designed to give investors exposure to the so-called "fear index." In doing so, Brar was essentially betting (on behalf of the Claimants) that the market would remain stable. Brar continued to rely upon and execute these trades after the Claimants converted their accounts to portfolio margin.

The parties dispute whether, and to what extent, FINRA Regulations (specifically, Rule 4210 and regulatory notice 08-09) permitted such trades to be executed using the portfolio margin. It is undisputed, however, that such trades were executed using the portfolio margin, and that they resulted in profits for the Claimants until late August of 2015.[7] Indeed, by the close of

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[6] Unlike Regulation T's initial margin requirement of 50% (2-1 leverage limit on equity), Portfolio Margin uses a sophisticated algorithm to calculate margin requirements based on the overall hypothetical risk of the portfolio (which, in turn, factors in the historical volatility of the underlying securities involved).

[7] It is clear from the "Arbitrator's Report" in both the first arbitration decision (ECF No. 1-2) and the second arbitration decision (ECF No. 71-1) that the arbitrators concluded that the VXX options were not eligible to be traded using portfolio margin.

markets on August 19, 2015, Sofis' account had a net asset value ("NAV") of $500,529.48 and the Saroops had a NAV of $520,450.40.

On Thursday, August 20, 2015, Brar continued this same strategy, selling hundreds of naked VXX call options. Over the next several days, however, the market experienced a spike in volatility, culminating on August 24, 2015, when the Dow experienced the largest one-day decline in its history. The parties dispute the cause of this volatility and decline: while Interactive attributes the loss to the market generally, the Claimants argue that the losses occurred, at least in part, because of the unreasonable "auto-liquidation" procedures deployed by Interactive.

Notwithstanding this factual dispute, both sides agree that by the time the market opened on August 24, the value of the Claimants' accounts had decreased by 80 percent. This precipitous drop caused the Claimants' accounts to fall into so-called "margin deficiency"–the equity remaining in the accounts had fallen below the minimum maintenance requirements. This margin deficiency, in turn, triggered Interactive's "auto-liquidation" procedures, which, in a period of about thirty minutes, wiped out the remaining balance in the Claimants' accounts (and left them with a still-large margin deficiency). The Claimants responded by bringing an arbitration claim against Interactive.

B. The First Arbitration Decision

In December 2015, the Claimants filed an arbitration claim with FINRA, as required by their contracts with Interactive. Their Statement of Claim ("SC") asserted multiple claims, including: breach of contract, promissory estoppel, violation of state securities statutes, commercially unreasonable disposition of collateral, negligent and intentional misrepresentation, unjust enrichment, and vicarious liability. SC ¶¶ 46-61 (ECF No. 1-10). Interactive filed an answer and counterclaim in response, seeking an award equal to the amount of the Claimants' debt remaining after their accounts had been liquidated. ECF No. 1-11. Both sides also sought attorneys' fees, and signed FINRA Uniform Submission Agreements, in which they agreed to submit the matters pled in the Statement of Claim, answer, and counterclaims for resolution by a FINRA arbitration panel (ECF No. 1-12). Although they had a right to do so under FINRA rules, neither side requested a reasoned award from the arbitrators.

An arbitration hearing was held from December 5, 2016 to December 9, 2016. Both sides presented fact and opinion testimony, including experts. Ultimately, on January 10, 2017, the panel rendered a monetary award in favor of the Claimants, including an award of attorneys' fees and a denial of Interactive's counterclaim. ECF No. 1-2. The arbitrators summarized the claims in the case as follows:

> Claimants asserted the following causes of action: breach of contract and promissory estoppel, violation of state securities statutes, commercially unreasonable disposition of collateral, vicarious liability, and common law fraud. The causes of action relate to unspecified securities.
>
> Unless specifically admitted in the Statement of Answer, Respondent denied the allegations made in the Statement of Claim and asserted various affirmative defenses.
>
> In its Counterclaim, Respondent asserted the following causes of action: failure to mitigate and pay a debt.

Id. at 3. The panel also noted that the Claimants withdrew their claim for allowing a non-registered broker to make trades at the close of the arbitration hearing. Id.

Because neither side requested a reasoned award, the arbitrators provided little explanation for their decision. The "Arbitrator's Report" consists of just three sentences, followed by details of the monies owed. In their entirety, the "ARBITRATOR'S REPORT" and "AWARD" state:

> **ARBITRATOR'S REPORT**
>
> The Claimants are awarded the value of their accounts on August 19, 2015 ($520,450.40 to the Saroops and $500,529.48 to Sofis). Respondent's Counterclaim was dismissed based on Respondent's violation of FINRA Rule 4210 as further explained in regulatory notice 08-09. The securities placed in the portfolio margin account were not eligible for that account based on these rules and regulations.
>
> **AWARD**
>
> After considering the pleadings, the testimony and evidence presented at the hearing, and the post-hearing submissions, the Panel has decided in full and final

resolution of the issues submitted for determination as follows:

1. Respondent is liable for and shall pay to Claimants Rohit and Preya Saroop compensatory damages in the amount of $520,450.40 plus interest at the rate of 8% per annum from 30 days of the date of the award until payment.

2. Respondent is liable for and shall pay to Claimants Rohit and Preya Saroop attorneys' fees representing 40% of the compensatory damages and 30% of the net claimed by Respondent for a total of $274,006.16. The Panel granted attorneys' fees pursuant to the parties' agreement.

3. Respondent is liable for and shall pay to Claimant George Sofis compensatory damages in the amount of $500,529.48 plus interest at the rate of 8% per annum from 30 days of the date of the award until payment.

4. Respondent is liable for and shall pay to Claimant George Sofis attorneys' fees representing 40% of the compensatory damages and 30% of the net claimed by Respondent for a total of $249,858.49. The Panel granted attorneys' fees pursuant to the parties' agreement.

5. Claimants' claim for witness fees is denied.

6. Respondent is liable for and shall pay to Claimants $600.00 as reimbursement of the non-refundable portion of the filing fee previously paid.

7. Respondent's Counterclaims are denied in their entirety.

8. Respondent's request for attorneys' fees is denied.

9. Any and all claims for relief not specifically addressed herein, including punitive damages, are denied.

Id. at 4. The remainder of the decision contained non-relevant information on arbitration fees. Id. at 5. Interactive moved for

this Court to vacate the first arbitration decision (ECF No. 1), while the Claimants sought to confirm it (ECF No. 18).

C. The Remand Opinion (ECF No. 50)

After considering the parties' motions to confirm and vacate the first arbitration decision, the Court did neither. Rather, it denied both motions, and remanded the matter to the original arbitrators to clarify their opinion. ECF No. 50.

The Court recognized the extreme deference owed to arbitrators' decisions. Id. at 11-14. However, it also noted that "[w]hen an arbitrator does provide reasons for a decision and when those reasons are so ambiguous as to make it impossible for a reviewing court to decide whether an award draws its essence from the agreement, the court may remand the case to the arbitrator for clarification." Cannelton Indus., Inc. v. Dist. 17, United Mine Workers of Am., 951 F.2d 591, 594 (4th Cir. 1991); ECF No. 50 at 14. The Court found the first arbitration decision to be a situation where remand was warranted.

First, the Court could not "concoct a scenario where the amount of compensatory damages awarded in this case makes sense." ECF No. 50 at 16. Nor could the Court determine what the arbitrators considered to be the predicate for liability. Id. The first arbitration decision was especially perplexing because it stated that "[a]ny and all claims for relief not specifically addressed herein, including punitive damages, are denied." ECF

No. 1-2 at 4. But, the award was in no way clear about which claims had been "specifically addressed." ECF No. 50 at 17. Further still, the damages awarded to the Claimants did "not correspond to any theory of liability that the Court can apprehend, much less the two principal theories of liability articulated by the Claimants at the arbitration."[8] Id. at 17.

Second, the award of attorney's fees was also quite perplexing. Id. at 19. The Court found a possible legal basis for the award of such fees (in the parties' agreement), but nothing supported a finding of percentage fees. Id. Accordingly, the Court concluded that the fee awarded also needed to be clarified.

In sum, the Court simply could not reconcile the first arbitration decision with any legal theories with which it was familiar. The Court refused to rubber stamp a decision it could not understand. Id. While "the arbitrators need not give a full opinion, a brief explanation for the basis of the amount of damages awarded is necessary before any semblance of judicial review can be accomplished." Id. at 20. Accordingly, the Court remanded the matter to the same panel of arbitrators for clarification as to the predicate for liability, how the damages were determined, and the basis for attorney's fees. Id. at 19-20.

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[8] These two theories were: (1) Interactive's allowance of ineligible securities to be traded on portfolio margin, and (2) Interactive's auto-liquidation procedure. ECF No. 50 at 17-18.

D. The Second Arbitration Decision

The arbitrators issued their second, modified decision on January 30, 2018. ECF No. 71-1. The modified decision only added a few sentences to the first arbitration decision. As far as explanations go, it was not very helpful.

Nearly identically to the first arbitration decision, the arbitrators summarized the case as follows (the new text is underscored):

> Claimants asserted the following causes of action: breach of contract and promissory estoppel, violation of state securities statutes, declaratory judgment, commercially unreasonable disposition of collateral, vicarious liability, and common law fraud. The causes of action relate to unspecified securities.
>
> Unless specifically admitted in the Statement of Answer, Respondent denied the allegations made in the Statement of Claim and asserted various affirmative defenses.
>
> In its Counterclaim, Respondent asserted the following causes of action: failure to mitigate and pay a debt.

Id. at 3. This list added "declaratory judgment" from the first arbitration decision. See ECF No. 1-2 at 2. Under "OTHER ISSUES CONSIDERED AND DECIDED," the arbitrators added a paragraph explaining the procedural history of the case, concluding with: "After due consideration, the Panel submits this Modified Award." ECF No. 71-1 at 3.

The next two sections of the second arbitration decision are the "ARBITRATOR'S REPORT" and "AWARD." Those sections repeat much

of the first decision and then add some text. In their entirety, those sections state as follows (with additions to the first arbitration decision underscored):

ARBITRATOR'S REPORT

The Claimants are awarded the value of their accounts on August 19, 2015 ($520,450.40 to the Saroops and $500,529.48 to Sofis). Respondent's Counterclaim was dismissed based on Respondent's violation of FINRA Rule 4210 as further explained in regulatory notice 08-09. The securities placed in the portfolio margin account were not eligible for that account based on these rules and regulations. Respondent's position that the Panel should not enforce a FINRA rule amounts to saying that FINRA should provide an opportunity for investors to commit financial suicide by investing in securities that are ineligible for inclusion in a portfolio margin account. To ignore a FINRA rule by the Panel would defeat the purpose of FINRA.

AWARD

After considering the pleadings, the testimony and evidence presented at the hearing, and the post-hearing submissions, the Panel has decided in full and final resolution of the issues submitted for determination as follows:

1. Respondent is liable for and shall pay to Claimants Rohit and Preya Saroop compensatory damages in the amount of $520,450.40 plus interest at the rate of 8% per annum from 30 days of the date of the award until payment.

2. Respondent is liable for and shall pay to Claimants Rohit and Preya Saroop attorneys' fees representing 40% of the compensatory damages and 30% of the net claimed by Respondent for a total of $274,006.16. The Panel granted attorneys' fees pursuant to the parties' agreement.

3. Respondent is liable for and shall pay to Claimant George Sofis compensatory damages in the amount of

$500,529.48 plus interest at the rate of 8% per annum from 30 days of the date of the award until payment.

4. Respondent is liable for and shall pay to Claimant George Sofis attorneys' fees representing 40% of the compensatory damages and 30% of the net claimed by Respondent for a total of $249,858.49. The Panel granted attorneys' fees pursuant to the parties' agreement.

5. There was no evidence of profits or losses in securities ineligible for portfolio management accounts from the time that the parties signed the portfolio management agreements and the parties' accounts' net asset values, all cash on August 19, 2015. Therefore, the panel could not consider what happened prior to the investment of cash on August 19, 2015 in the portfolio management accounts.

The damages set forth above stem from the amounts, all cash, on August 19, 2015, which were subsequently invested in securities that were ineligible for investment in portfolio margin accounts. Values were determined from Claimants' Exhibits 70 and 71 and Respondent's Exhibits R-48 and R115.

Counsel fees were based on an agreement between the attorneys for both parties. There was a dispute as to whether the agreement was cancelled. The Panel found for the Claimants. The amounts were based on a written fee agreement between the counsel and each party. Percentages and fees were obtained from Claimants' Exhibits 53 and 63 and Respondent's Exhibit R-49.

6. Claimants' claim for witness fees is denied.

7. Respondent is liable for and shall pay to Claimants $600.00 as reimbursement of the non-refundable portion of the filing fee previously paid.

8. Respondent's Counterclaims are denied in their entirety.

9. Respondent's request for attorneys' fees is denied.

10. Any and all claims for relief not specifically addressed herein, including punitive damages, are denied.

ECF No. 71-1 at 4-5 (new text underscored). Again, the remainder of the arbitrator's decision dealt with non-relevant filing fees. Id. at 5-6.

In sum, the second arbitration decision added "declaratory judgment" as one of the causes of action asserted by the Claimants; it added a brief procedural history of the case leading to the second, modified award; it added two sentences to the "Arbitrator's Report" regarding FINRA rules; and it added Paragraph Five of the "Award" explaining the calculation of damages.

E. Procedural Posture

Following the second arbitration decision, Interactive filed PLAINTIFF'S MOTION TO VACATE MODIFIED ARBITRATION AWARD (ECF No. 79) on March 26, 2018; Claimants filed DEFENDANT'S MOTION TO CONFIRM THE MODIFIED ARBITRATION AWARD on the same day (ECF No. 80). The parties briefed the matter fully (ECF Nos. 81-85; 89; 91). Thereafter, the Court heard oral argument, and both motions were fully submitted to the Court. The matter is now ripe for decision.

LEGAL STANDARD

Section 10 of the Federal Arbitration Act sets out the specific, limited grounds upon which an arbitral award may be vacated. They include:

> (1) where the award was procured by corruption, fraud, or undue means;

> (2) where there was evident partiality or corruption in the arbitrators, or either of them;
>
> (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
>
> (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10(a). The Supreme Court has issued further instructions interpreting the fourth of these circumstances: where arbitrators exceed their powers.

In Oxford Health Plans LLC v. Sutter, 133 S. Ct. 2064 (2013), the Supreme Court explained that "a party seeking relief under § 10(a)(4) bears a heavy burden." Id. at 2068. The Court instructed further:

> It is not enough . . . to show that the arbitrator committed an error—or even a serious error. Because the parties bargained for the arbitrator's construction of their agreement, an arbitral decision even arguably construing or applying the contract" must stand, regardless of a court's view of its (de)merits. Only if the arbitrator acts outside the scope of his contractually delegated authority—issuing an award that simply reflects his own notions of [economic] justice rather than drawing its essence from the contract—may a court overturn his determination. So the sole question for us is whether the arbitrator (even arguably) interpreted the parties' contract, not whether he got its meaning right or wrong.

Id. at 2068 (internal citations and quotations omitted).

The Fourth Circuit has explained that an arbitration award may be vacated on common law grounds where it "fails to draw its essence from the contract," or where the award demonstrates a "manifest disregard of the law." See Choice Hotels Int'l, Inc. v. SM Prop. Mgmt., LLC, 519 F.3d 200, 207 (4th Cir. 2008). An award fails to draw its essence from the contract "when an arbitrator has disregarded or modified unambiguous contract provisions or based an award upon his own personal notions of right and wrong." Three S Delaware, Inc. v. DataQuick Info. Sys., Inc., 492 F.3d 520, 528 (4th Cir. 2007).

Manifest disregard of the law requires the moving party to show that the arbitrator was "aware of the law, understood it correctly, found it applicable to the case before [him], and yet chose to ignore it in propounding [his] decision." Long John Silver's Restaurants, Inc. v. Cole, 514 F.3d 345, 349 (4th Cir. 2008). This standard is "not an invitation to review the merits of the underlying arbitration," and will apply only where: "(1) the disputed legal principle is clearly defined and is not subject to reasonable debate; and (2) the arbitrator refused to apply that legal principle." Jones v. Dancel, 792 F.3d 395, 402-03 (4th Cir. 2015), cert. denied, 136 S. Ct. 591 (2015). A district court cannot overturn an arbitration award "just because it believes, however strongly, that the arbitrators misinterpreted the applicable law."

Id. at 401 (quoting Wachovia Sec., LLC v. Brand, 671 F.3d 472, 478 (4th Cir. 2012)). The arbitrators must disregard it.

Notwithstanding these possible grounds for vacatur, the Fourth Circuit has repeatedly emphasized that "judicial review of an arbitration award in federal court is severely circumscribed." Id. (quoting Apex Plumbing Supply, Inc. v. U.S. Supply Co., 142 F.3d 188, 193 (4th Cir. 1998)). Indeed, the Fourth Circuit has described such review as "among the narrowest known at law," Apex, 142 F.3d at 193, and has instructed that "a court sits to determine only whether the arbitrator did his job—not whether he did it well, correctly, or reasonably, but simply whether he did it." Wachovia, 671 F.3d at 478 (internal citations omitted). Thus, "as long as the arbitrator is even arguably construing or applying the contract and acting within the scope of his authority, that a court is convinced he committed serious error does not suffice to overturn his decision." Choice Hotels, 519 F.3d at 207 (quoting U.S. Postal Serv. v. Am. Postal Workers Union, AFL-CIO, 204 F.3d 523, 527 (4th Cir. 2000)).

In sum, this Court "'must' confirm an arbitration award 'unless' a party to the arbitration demonstrates that the award should be vacated under" one of the permissible grounds, which includes manifest disregard of the law. Dancel, 792 F.3d at 401 (quoting Hall St. Assocs., L.L.C. v. Mattel, Inc., 552 U.S. 576, 582 (2008)).

DISCUSSION

With this framework in mind, the Court moves to the merits of the case, fully aware of its limited role in reviewing the arbitration decision. Still, the arbitration decision must comport with the law. After thoroughly reviewing the record in this case—especially in light of the specific instructions that the Court gave the arbitrators in the Remand Opinion—the Court concludes that the arbitrators based their finding of liability against Interactive on a violation of FINRA Rule 4210. That is a manifest disregard of the law because the law is clear that there is no private right of action to enforce FINRA rules; the arbitrators knew of and understood the law on this point; they found it to be applicable to the case; and they ignored it. When such manifest disregard for the law occurs, the Court must vacate the arbitration award. Because the arbitrator's impermissible finding of liability is the basis for the damages and attorney's fees award against Interactive, those findings are also erroneous. Accordingly, the Court will only deal with the liability issue here. Lastly, because the arbitrators dismissed Interactive's counterclaims based on the alleged violation of FINRA Rule 4210, the Court will reinstate those claims and remand to a new panel of arbitrators for consideration thereof.

A. The Arbitrators' Liability Determination is Predicated on a Violation of FINRA Rule 4210

The arbitrators' second arbitration decision does not expressly state that it is basing its liability finding against Interactive on any of the causes of action recited in the award. The decision starts with a list of the causes of actions asserted by the Claimants—breach of contract and promissory estoppel, violation of state securities statutes, declaratory judgment, commercially unreasonable disposition of collateral, vicarious liability, and common law fraud. ECF No. 71-1 at 3. These causes of action "relate to unspecified securities." Id.[9]

After identifying those potential causes of action, the "ARBITRATOR'S REPORT" makes a finding of liability against Interactive without stating which cause of action serves as the basis for such liability or how damages were determined. Indeed, the "REPORT" does not identify any of the specified causes of action delineated on the previous page of the decision as the predicate for the award. More importantly, the only basis for liability cited by the arbitrators in their modified award—after they were specifically instructed by the Court to provide an

[9] The arbitrators then state that in Claimants' "Statement of Claim" they requested: compensatory damages, direct or consequential damages, market adjusted damages and/or punitive damages, interest, lost opportunity damages, rescission, statutory damages, costs, legal fees, and any and all other relief available. Id.

explanation for the predicate for liability—is a violation of FINRA Rule 4210.

In the first arbitration decision, the "ARBITRATOR'S REPORT" stated that Interactive's counterclaims were dismissed "based on" Interactive's "violation of FINRA Rule 4210" and that the "securities placed in the portfolio margin account were not eligible for that account based on these rules and regulations." ECF No. 1-2 at 4 (emphasis added). In the second arbitration decision, the arbitrators appear to double down on their reliance of a FINRA rule violation as the basis for liability by adding the following two sentences—and only these sentences—to the "REPORT":

> Respondent's position that the Panel should not enforce a FINRA rule amounts to saying that FINRA should provide an opportunity for investors to commit financial suicide by investing in securities that are ineligible for inclusion in a portfolio margin account. To ignore a FINRA rule by the Panel would defeat the purpose of FINRA.

ECF No. 71-1 at 4. This is the only explanation in the modified "ARBITRATOR'S REPORT" that relates to the predicate for liability.[10]

[10] In the modified "AWARD," where the arbitrators attempt to explain the damages calculation, they also appear to double-down on a FINRA rule violation: "The damages set forth above stem from the amounts . . . which were subsequently invested in securities that were ineligible for investment in portfolio margin accounts." ECF No. 71-1 at 4 ¶ 5.

Further support for that conclusion is found in the final paragraph of the "AWARD," where the arbitrators write: "Any and all claims for relief not specifically addressed herein, including punitive damages, are denied." Id. at 5 ¶ 10. In the Remand Opinion (ECF No. 50), the Court noted that the first arbitration decision's use of this identical language was unclear: "[O]ne cannot discern from the Arbitrator's Report or the Award which claims for relief were, as the arbitrator put it, 'specifically addressed.'" ECF No. 50 at 17. Instead of following the Court's instruction to clarify the predicate for liability, however, the arbitrators used the same "specifically addressed" language and added language about FINRA rule violations. By process of elimination, if all other claims were rejected (by the arbitrators' express admission) and the only language added to the "ARBITRATOR'S REPORT" indicates that liability is predicated on a FINRA Rule 4210 violation, it is hard for the Court to conclude anything other than that a violation of FINRA Rule 4210 is the basis for liability here.[11]

[11] In the DEFENDANT'S OPPOSITION TO PLAINTIFF'S MOTION TO VACATE THE MODIFIED ARBITRATION AWARD (ECF No. 85), the Claimants concede that commercially unreasonable disposition of collateral, vicarious liability, and declaratory judgment were likely not the basis for liability here. ECF No. 85 at 12. Accordingly, Claimants assert that breach of contract and promissory estoppel, violation of state securities statutes, and common law fraud remain as bases for the arbitrator's finding of liability. Id.; see also Oral Arg. Tr. at 45 (ECF No. 94). However, on its face, the arbitration decision makes clear that liability is predicated on a violation of FINRA Rule 4210.

The arbitrators were on notice that the Court was perplexed by the "specifically addressed" language and to the extent they clarified their award, they have made it clear that they "specifically addressed" FINRA Rule 4210.

B. The Arbitrators' Award Manifestly Disregards the Law in Relying on FINRA Rule 4210 as the Predicate for Liability

It is a manifest disregard of the law to predicate liability on a violation of FINRA Rule 4210. Accordingly, the arbitration award cannot stand.

Distilling the Fourth's Circuit's "manifest disregard" cases, the Court uses the following framework to assess this issue. First, the legal principle must be "clearly defined and. . .not subject to reasonable debate." Dancel, 792 F.3d at 402. Second, the arbitrators must have: (1) been aware of this clearly defined law, (2) understood that law correctly, (3) found that law applicable to the case before them, and (4) ignored that law in coming to a decision. See Long John Silver's, 514 F.3d at 349. Each of these elements has been met in this case.

1. The Law Is Clearly Defined That There Is No Private Right of Action Under FINRA Rules

The clear weight of authority holds that a violation of the rules of a financial self-regulatory entity like FINRA (or its

predecessor, NASD)[12] does not give rise to a private right of action. More than 40 years ago, the Fourth Circuit considered whether New York Stock Exchange ("NYSE") Rules or American Stock Exchange ("ASE") Rules governing margin maintenance requirements created a private right of action for an investor. Carras v. Burns, 516 F.2d 251, 260 (4th Cir. 1975). The Court of Appeals found that, because "[m]argin maintenance requirements are established primarily to protect the solvency of brokers by assuring adequate collateral for their loans that finance consumer speculation," these requirements standing alone "create no cause of action" for the investor. Id. While Carras did not deal with FINRA rules, it did deal with margin requirements like those in this case and those in FINRA Rule 4210. The Court does not discern a material difference between violations of the NYSE or ASE margin rules in Carras and FINRA Rule 4210 here. See also Stern v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 603 F.2d 1073 (4th Cir. 1979) (finding no private right of action to enforce Regulation T credit rules).

Other cases cited by Interactive in its briefing both to the Court and to the arbitrators further establish that there is no private right of action to enforce FINRA or NASD rules. For

[12] FINRA succeeded NASD in 2007. See Santos-Buch v. Fin. Indus. Regulatory Auth., Inc., 591 Fed. Appx. 32 (2d Cir. 2015) (unpublished).

example, in Weinraub v. Glen Rauch Secs., Inc., the Court rejected Weinraub's securities fraud allegations on several grounds, including that he could not "state a valid cause of action based on violations of [NYSE] and NASD rules and guidelines, as these rules confer no private right of action." 399 F. Supp. 2d 454, 462 (S.D.N.Y. 2005) (footnotes omitted). See also Thompson v. Smith Barney, Harris Upham & Co., Inc., 709 F.2d 1413, 1419 (11th Cir. 1983) (rejecting contention that there is private right of action under federal securities laws for violation of NYSE and NASD Rules); SSH Co., Ltd. v. Shearson Lehman Bros. Inc., 678 F. Supp. 1055, 1058 (S.D.N.Y. 1987) (same); Parsons v. Hornblower & Weeks-Hemphill Noyes, 447 F. Supp. 482, 494 (M.D.N.C. 1977) ("Under the clear weight of authority, there is no private right of action for alleged violations of NASD rules in the absence of facts which demonstrate fraud, independently cognizable under the antifraud provisions of the securities laws.").

In a Notice of Supplemental Authority (ECF No. 89), Interactive also cites to a recent Southern District of New York case, Hauptman et al. v. Interactive Brokers, LLC, No. 1:17-cv-09382-GBD (S.D.N.Y. June 12, 2018).[13] The Court stated unequivocally that "no private right of action exist[s]. . . for

[13] Interactive also provided a more recent opinion in Hauptman, No. 1:17-cv-09382-GBD (S.D.N.Y. Oct. 19, 2018), that denied the Plaintiffs' Motion to Amend based on the futility of such an amendment. ECF No. 91.

violations of. . .FINRA rules." Hauptman, slip op. at 15 (quoting Lobaito v. FINRA, No. 13-cv-6011, 2014 WL 4470423, at *7 n.3 (S.D.N.Y. Sept. 9, 2014)). Hauptman was decided after the arbitrators decided this case, so it cannot serve as a basis to establish that the law was clearly defined on this issue when the arbitrators had this matter before them. Hauptman quotes the earlier Lobaito case, which pre-dated the arbitration in this case, and thus could establish this principle of law. Lobaito, however, was discussing whether there was a private right of action against FINRA for actions it takes "in furtherance of its regulatory duties, including enforcement of its own rules." Lobaito, 2014 WL 4470423, at *7 & n.3. Private rights of action against FINRA are not at issue in the instant case.

Nonetheless, Hauptman also cites to Gurfein v. Ameritrade, Inc., discussed infra. In Gurfein, the Second Circuit taught that there is no private right of action under the rules of organizations like FINRA. 312 Fed. Appx. 410, 414 (2d Cir. 2009) (stating that "Gurfein does not contend that the regulatory rules themselves provide investors with a private right of action" and "Gurfein is precluded from creating a private cause of action for violations of these rules and regulations by fashioning her claim as one for breach of contract"). Thus, even leaving Lobaito and Hauptman aside, it is clear that the Second Circuit understood there was no private right of action under rules of entities like

FINRA. Further, the Court has not found—nor have the Claimants provided—any case that holds that there is a private right of action to enforce violations of FINRA rules. Accordingly, the Court considers that question—whether there is a private right of action to enforce FINRA rules—to be beyond dispute.[14]

Undeterred, Claimants also attempt to make the more nuanced argument that a violation of FINRA rules can provide the basis for a common law claim. To that end, they argue that a violation of FINRA rules could have supported a finding by the arbitrators that Interactive violated one of the common law causes of action. See, e.g., ECF No. 85 at 13-14. By making this argument, the Claimants concede that the arbitrators were relying on a violation of FINRA Rule 4210 to establish liability, but were doing so to establish one of the common law claims.

Claimants also cite several cases that they think support their theory. Those cases, however, are about using FINRA rules to define the scope of a common law duty—or to provide evidence of whether that duty was met—not about establishing the predicate for liability in the first place.

In Rioseco v. GAMCO Asset Mgmt., a New York state trial court decision, the court considered whether FINRA rules (there, the so-

[14] Counsel for the Claimants conceded this point at oral argument, answering "no" when directly asked by the Court if there were any cases holding that there is a private right of action to enforce FINRA rules. Oral Arg. Tr. at 28 (ECF No. 94).

called "suitability rules") could "be considered as evidence of industry standards for purposes of a common law malpractice claim." No. 15862/10, Seq. No. 003, 2011 WL 4552544, at *79 (N.Y. Sup. Ct. Sept. 23, 2011) (emphasis added). The Rioseco court noted that a violation of FINRA rules does not give rise to a private cause of action. Id. However, since the court had already determined that GAMCO owed fiduciary duties to Rioseco, the violation of the FINRA rules could be probative of "whether GAMCO committed malpractice." Id. at *80.

The Rioseco court understood the difference between FINRA rules creating a private cause of action and their informing the scope of existing causes of action and common law duties. If a FINRA rule "gave rise to a private right of action, the violation of the rule, standing alone, would be sufficient to impose liability." Id. at *79. There is no private right of action under FINRA rules, but the Rioseco court found that the rules could provide evidence of whether there was malpractice once it established that GAMCO owed a fiduciary duty. In the instant case, the Court cannot ascertain which common law cause of action that a FINRA rule violation could inform. The arbitrators state that they are denying "any and all claims for relief not specifically addressed herein," yet only address a violation of FINRA rules. ECF No. 71-1 at 4-5. That implies that the basis for liability is a FINRA rule violation. Accordingly, Rioseco is not on point.

The same analysis holds true for other cases cited by the Claimants. Those cases all deal with using a violation of FINRA or NASD rules to provide evidence of a violation of an existing common law cause of action, like negligence. They do not use the FINRA or NASD rule violation as an independent cause of action as the arbitrators did here. See Milliner v. Mut. Secs., Inc., 297 F. Supp. 3d 1060, 1065 (N.D. Cal. 2016) ("[C]ourts have often looked to such rules in defining the scope of common law duties."); Walnut St. Secs. v. Lisk, 497 F. Supp. 2d 714, 719-720 (M.D.N.C. 2007) (violation of NASD rules could be basis for failure to supervise liability); Scott v. Dime Sav. Bank of New York, FSB, 886 F. Supp. 1073, 1080-81 (S.D.N.Y. 1995) (jury could have considered evidence of NASD rule violation in determining negligence); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cheng, 697 F. Supp. 1224, 1227 (D.D.C. 1988) (violation of NASD rule may be considered by jury in determining negligence). These cases make clear that violating a FINRA or NASD rule can be considered in defining the scope of a common law duty. But here, the arbitrators state that they are rejecting all claims not specifically addressed and only address the FINRA rule violation. There, thus, is no common law claim upon which they could have based the finding of liability.

Further still, recent Second Circuit case law holds that an investor may not create a private right of action for the violation of financial regulatory rules, including NASD rules, by

refashioning his claim as a breach of contract claim. Gurfein v. Ameritrade, Inc., 312 Fed. Appx. 410, 412-14 (2d Cir. 2009). In Gurfein, the plaintiff's Customer Agreement with her online financial brokerage firm stated that "[a]ll transactions under this Agreement are made subject to the constitution, rules, regulations, customs and usages of the various execution points and their clearinghouse, if any." Id. at 413. The Second Circuit determined that such a clause "is a notice provision that informs the customer that her trades are constrained by the rules of governing regulatory agencies" and did not "impose[] [contractual] obligations" on the broker-dealer. Id. at 413-14. Gurfein could not "creat[e] a private cause of action for violations of [financial regulatory] rules and regulations by fashioning her claim as one for breach of contract based on violations of rules and regulations impliedly incorporated into the agreement." Id. at 414.

Like Gurfein, this case involves a Customer Agreement that acknowledges that "[a]ll transactions are subject to rules and policies of relevant markets and clearinghouses, and applicable laws and regulations." Interactive Brokers LLC Customer Agreement ¶ 6 (ECF No. 1-4). And, like Gurfein, this provision puts the customer on notice about how his trades will be governed. But, as the Second Circuit has made clear, it does not create a private

cause of action for violation of financial regulatory rules and regulations under a breach of contract theory.

The Court is satisfied that the law is clearly defined that there is no private right of action to enforce FINRA rules. Because it is apparent on the face of the arbitrator's decision that a violation of FINRA Rule 4210 is the basis for liability in this case, that is the end of the matter. Claimants' argument that FINRA or NASD rules can provide evidence to support a common law cause of action presupposes that one exists. Where the arbitrators state that they are rejecting all claims not specifically addressed, and only address a violation of FINRA rules, cases of that hue are simply inapposite.

2. The Arbitrators Knew the Law, Understood It, Knew It Was Applicable, and Disregarded It

Once it is established that the law on the issue is clearly defined, the next step in the "manifest disregard of the law" analysis is to show that the arbitrators knew the law, understood it, knew it was applicable, and disregarded it. See Long John Silver's, 514 F.3d at 349; see also Raymond James Fin. Servs. v. Bishop, No. 3:07-cv-28, slip op. at 28 (E.D. Va. Dec. 18, 2008), aff'd, 596 F.3d 183 (4th Cir. 2010).

It is clear that the arbitrators knew the law because Interactive made clear in their briefing to the arbitrators that there was no private right of action for violation of FINRA rules.

See Raymond James, slip op. at 28 ("Raymond James correctly informed the panel of the principle in its Motion to Dismiss. . . ."). In both its pre-hearing brief before the arbitrators and its memorandum in support of its motion for summary judgment (ECF No. 31), Interactive cited clear authority establishing that there is no private right of action for violation of FINRA rules. See ECF No. 82 at 4-6 (discussing the two ways in which Interactive provided law to the arbitrators). The arbitrators were aware of the law cited in these briefs because they state that "they have each read the pleadings and other materials filed by the parties." ECF No. 71-1 at 2. Accordingly, the Court finds that the arbitrators were aware of the law.

Second, the arbitrators understood the law. This Court in Raymond James found that arbitrators understood the "causation element of a fiduciary damages claim" because the arbitrators were "licensed attorneys" and such knowledge is "hornbook law. . . required. . .for admission to the bar." Raymond James, slip op. at 29. As Interactive points out, the chairman of the arbitration panel here is an attorney and he stated that the panel members "are not uneducated or inexperienced jurists." ECF No. 82 at 6. In the Remand Opinion (ECF No. 50), the Court instructed that the arbitrators needed to make clear the predicate for liability. That damages must be tied to a recognized cause of action is "hornbook law." And, since at least one of the arbitrators is an attorney

and represented that the members of the panel are "not. . .inexperienced jurists," the Court finds that the arbitrators understood the law in this case.

Third, the arbitrators knew the law was applicable. Once again, the arbitrators had the benefit of this Court's Remand Opinion in which the Court instructed the arbitrators to tie damages to a cause of action. ECF No. 50 at 17. Further, the arbitrators acknowledged Interactive's position by stating in the "ARBITRATOR'S REPORT": "Respondent's position that the Panel should not enforce a FINRA rule amounts to saying that FINRA should provide an opportunity for investors to commit financial suicide. . . ." ECF No. 71-1 at 4. The arbitrators knew they had to tie the damages to a cause of action. They knew that Interactive's position was that there was no private right of action to enforce FINRA rules. They knew that the law applied to this case because they stated it in their "REPORT." On this record, the Court finds this element to be satisfied.

Finally, the arbitrators disregarded the law by finding Interactive liable solely on the basis of violating FINRA Rule 4210. They were aware of the law, understood it, and knew it was applicable to the case. After receiving clear guidance from this Court that they needed to establish a predicate for liability, the arbitrators doubled down by adding to their "REPORT" more language about violating FINRA rules rather than discussing one of the

claims for relief stated in the "CASE SUMMARY." See ECF No. 71-1 at 3-4. On this record, the Court has no choice but to find that the arbitrators utterly disregarded the law that FINRA rules provide no private case of action.[15]

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[15] Claimants cite several cases to refute that the Court is able to determine from the face of the award that the panel acted in manifest disregard of the law. None of these cases support that proposition in this case. In Waveland Capital Partners, LLC v. Tommerup, 928 F. Supp. 2d 1227 (D. Mont. 2013), the Court rejected an argument that it could determine that the arbitrators based a finding of liability on "violations of self-regulatory organization rules." Id. at 1232. That case is different for two reasons. First, the arbitrators did not even address the self-regulatory organization (like FINRA) rules. Id. Second, the Court found several grounds upon which the arbitrators could have based their award. Id. at 1233. Neither of those situations are present here: the arbitrators expressly discussed a FINRA rule violation and the Court cannot find another basis for the finding of liability.

In The GMS Group, LLC v. Benderson, 326 F.3d 75 (2d Cir. 2003), the Second Circuit found that arbitrators did not act in manifest disregard of the law in applying NASD rules. But in that case, there was no written opinion by the arbitrators, id. at 81, and the Court determined that the facts and the law were unclear such that it could not say the arbitrators acted in manifest disregard of the law. Id. at 82-83. This case differs because the Court does have an opinion and the law is clear. Thus, the Court can determine that the arbitrators manifestly disregarded the law.

Lastly, Claimants cite two New York state cases. In a half-page opinion, a New York trial court rejected a challenge to an arbitration decision that "concerned the alleged breach of two rules of" NASD. Freeman v. Arahill, No. 111119/01 (N.Y. Sup. Ct. Oct. 18, 2001). It did so because Freeman did "not cite any case law for the proposition that a private right of action based on the violation of self-regulatory organization rules cannot be brought in arbitration." Id. While this statement cuts against the Court's determination here, the Court is not convinced by an unreasoned, half-page state trial court decision in the face of the other authority cited in this opinion. Claimants also cite In re Grace Fin. Group, LLC v. Dino, which upheld an arbitration award

In sum, the Court finds that the law applicable in this case is clearly defined—there is no private right of action for the violation of FINRA rules. The Remand Opinion put the arbitrators on notice that they were to tie their damages award to a cause of action. Rather than explaining which of the stated causes of action they relied on, they added more language about FINRA rule violations. In so doing, the arbitrators made it quite clear that liability was based solely on Interactive's violation of FINRA Rule 4210. Further, the arbitrators knew of the law, understood it, knew it to be applicable, and continued to disregard it. All of the elements for vacatur for manifest disregard of the law have been met. See Dancel, 792 F.3d at 402; Long John Silver's, 514 F.3d at 349. Accordingly, the PLAINTIFF'S MOTION TO VACATE MODIFIED ARBITRATION AWARD (ECF No. 79) will be granted.

C. Interactive's Counterclaims

Before concluding, however, it is necessary briefly to address Interactive's counterclaims. During arbitration, Interactive asserted counterclaims against the Claimants for failure to mitigate and pay a debt. ECF No. 71-1 at 3. It requested dismissal of the Claimants' claims, compensatory damages of

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as not manifestly disregarding the law where the award did not refer to FINRA rules, but rather characterized the claim as asserting "only excessive fees and mark-ups." 138 A.D. 3d 644, 645 (N.Y. App. Div. 2016). The Court implied, however, that if, like here, the arbitrators had sought to use FINRA rules to establish a private cause of action, the award would have been vacated. Id.

$220,172.09 from Rohit and Preya Saroop, compensatory damages of $166,087.53 from Dr. Sofis, interest, costs, and attorney's fees. Id. The "ARBITRATOR'S REPORT" briefly assesses Interactive's counterclaims: "Respondent's Counterclaim was dismissed based on Respondent's violation of FINRA Rule 4210 as further explained in FINRA Regulatory Notice 08-09." Id. at 4. Finally, in the "AWARD," the arbitrators denied Interactive's Counterclaims "[i]n their entirety," as well as denied Interactive's request for attorney's fees. Id. at 5 ¶¶ 8-9.

Because the Court has determined that it was manifest disregard of the law for the arbitrators to award damages to the Claimants based solely on the violation of FINRA Rule 4210, it was likewise improper to dismiss the counterclaim on this same ground. If FINRA Rule 4210 cannot support a finding of liability standing alone, neither can it provide a sort of affirmative defense that the arbitrators can use to reject Interactive's counterclaims.

But, given the difficulty that the arbitrators in this case had in following the Court's previous order (ECF No. 50) and their rather flagrant disregard of settled law in ruling against Interactive, the Court cannot in good conscience remit Interactive to the same panel of arbitrators for reconsideration of its counterclaims. See, e.g., Montes v. Shearson Lehman Bros., Inc., 128 F.3d 1456, 1464 (11th Cir. 1997) (remanding to new panel of arbitrators where original panel was found to manifestly disregard

the law). Accordingly, the Court reinstates Interactive's counterclaims and remands to a FINRA arbitration panel with specific instructions that the counterclaims be considered by a different FINRA arbitration panel.

CONCLUSION

For the reasons set forth above, it is hereby ORDERED that the PLAINTIFF'S MOTION TO VACATE MODIFIED ARBITRATION AWARD (ECF No. 79) is GRANTED and the DEFENDANT'S MOTION TO CONFIRM THE MODIFIED ARBITRATION AWARD (ECF No. 80) is DENIED. Furthermore, it is hereby ORDERED that this matter is be remanded to a new panel of FINRA arbitrators for reconsideration of Interactive's counterclaims.

It is so ORDERED.

/s/ REP

Robert E. Payne
Senior United States District Judge

Richmond, Virginia
Date: December 18, 2018

RECORD NUMBER: 19-1077

United States Court of Appeals

for the

Fourth Circuit

INTERACTIVE BROKERS LLC,

Plaintiff/Appellee,

– v. –

ROHIT SAROOP; PREYA SAROOP; and GEORGE SOFIS,

Defendants/Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA AT RICHMOND

BRIEF OF *AMICUS CURIAE* PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION IN SUPPORT OF APPELLANTS

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CORPORATE DISCLOSURE STATEMENT

The Public Investors Arbitration Bar Association ("PIABA") is a non-profit international bar association comprised of attorneys who represent investors in securities arbitrations, as well as state securities regulators and faculty at law schools who work on investor issues. PIABA has no parent corporation, and no publicly held corporation owns 10% or more of any of PIABA's stock.

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STATEMENT OF IDENTITY, INTEREST, AND AUTHORITY TO FILE[1]

PIABA is an international bar association comprised of attorneys who represent investors in securities arbitrations, as well as state securities regulators and faculty at law schools who work on investor issues. Since its formation in 1990, PIABA has promoted the interests of public investors in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and securities industry misconduct.

PIABA members regularly represent public investors in securities arbitration disputes against financial advisors, registered representatives and broker-dealers registered by the Securities and Exchange Commission ("SEC") and the Financial Industry Regulatory Authority ("FINRA"). Our members and their clients have a strong interest in protecting public investors and customers of the securities industry from the misconduct of members of the securities industry, and in creating a level playing field for public investors and customers of the securities industry in securities disputes with industry members.

To fulfill its role as a voice for public investors and customers of broker-dealers, PIABA frequently files *amicus* briefs in cases likely to impact the rights and

[1] The Appellants consent to the filing of the proposed amicus brief. The Appellee, Interactive Brokers, consents to the filing of the proposed amicus brief, but notes that it may ask the Court for an extension of its word/page limit to address any arguments the Amici may make that are not duplicative of those made by the Appellants.

protections afforded to public investors and customers of broker-dealers. PIABA identified this case as having statewide or national significance, and files out of concern that the Eastern District of Virginia's rulings will seriously undermine the finality of arbitration, and the strong public policy favoring arbitration. *E.g.*, *Hall Street Assocs. v. Mattel, Inc.*, 552 U.S. 576, 581 (2008).

STATEMENT REGARDING PARTICIPATION

Pursuant to Fed. R. App. P. 29(a)(4)(E), PIABA states that (i) neither party's counsel authored this Brief in whole or in part; (ii) neither a party nor a party's counsel contributed money that was intended to fund preparing or submitting this Brief; and (iii) no person—other than the amicus curiae, its members, or its counsel—contributed money that was intended to fund preparing or submitting this Brief.

ARGUMENT

I. Public policy favors arbitration, which may offer benefits over court.

Courts considering *vacatur* of arbitration awards often invoke the important national policy favoring arbitration. *See, e.g.*, *Hall Street Assocs.*, 552 U.S. at 581. Arbitration has the potential to offer a faster, more efficient alternative to court litigation. For example, FINRA, the self-regulatory organization for the brokerage industry and the provider of the largest securities arbitration forum touts a faster, more efficient alternative to litigation. Financial Industry Regulatory Authority,

FINRA Office of Dispute Resolution Arbitrator's Guide p. 9 (Nov. 2018), *available at* www.finra.org/sites/default/files/arbitrators-ref-guide.pdf. Linda Fienberg, then-president of NASD Dispute Resolution, told the North American Securities Administrators Association in 2004 that "[a]rbitration is … more efficient and cheaper" than litigating in court.[2]

In addition to providing efficiency, FINRA points out other benefits of arbitration. FINRA says "'it is equitable to prefer arbitration to the law court, for the arbitrator keeps equity in view, whereas the judge looks only to the law, and the reason why arbitrators were appointed was that equity might prevail.'" FINRA ARBITRATOR'S GUIDE p. 9 (quoting Domke on Aristotle).

With the promise of arbitration being cheaper and faster than litigation, it is critical that courts not allow arbitration to become a litigation-like process "for protracting disputes." *See Wachovia Sec., LLC v. Brand*, 671 F.3d 472, 478, n.5 (4th Cir. 2012). FINRA member firms are much better funded for prolonging and complicating dispute resolution than a typical customer.[3]

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[2] Remarks of Linda Fienberg, NASAA Listens Forum on Arbitration, National Press Club, Washington, D.C., July 20, 2004 (below, Fienberg Remarks to NASAA). An audio file of Ms. Fienberg's Remarks to NASAA is available at http://www.connectlive.com/events/nasaa/. The text of her remarks is available as Appendix N in Seth Lipner, Joseph Long, & William Jacobson, SECURITIES ARBITRATION DESK REFERENCE (Thomson Reuters 2016-17 ed.).

[3] As Ms. Fienberg told NAASA, allowing arbitration to become like litigation in court would allow a large, retail brokerage firm to bankrupt a customer asserting a

II. FINRA Rules do not require the claimant to specify any cause of action or legal theory in a claim.

Consistent with the promise of efficiency, FINRA arbitration rules do not require a brokerage firm customer to plead a cause of action or legal theory to initiate an arbitration. Under FINRA Dispute Resolution Rule 12302, a customer needs only to file a signed and dated submission agreement along with the customer's statement of claim. The statement of claim need only "specify[] the relevant facts and remedies requested." *Id.* FINRA Rules do not require a customer to specify or identify any particular legal cause of action.

The customers' statement of claim in this case identified a number of causes of action asserted against IB, but it was not required to do so. *See* Statement of Claim ¶¶46-58, available at Filing 1-10 at CM/ECF p. 96-99.[4] Under Rule 12302(a), a statement of claim specifying only the relevant facts and the remedies the customer requests would have sufficed. As long as the customer also pays the correct fee for commencing the arbitration as provided in Rule 12302(b), then FINRA is obligated

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claim. Fienberg Remarks, *supra* n.1. Ms. Fienberg was referring to the discovery process. The judicial review process is every bit as expensive and time consuming as discovery.

[4] At this time, PIABA does not have access to a copy of the Record or Appendix on Appeal, and accordingly cites to either unpublished opinions available on LEXIS or the CM/ECF citations for the Eastern District of Virginia Case No. 3:17-cv-127 throughout. PIABA would be happy to update these citations after the Appendix is available, at the Court's request.

to serve the statement of claim on the respondent firm, which triggers the respondent firm's obligation to file an answer. FINRA Rule 12302(c). To be clear, if FINRA has served a statement of claim—even a statement of claim that has not identified any cause of action—that necessarily means it was sufficient under FINRA Rules, and the respondent firm has no right or procedure for requiring any further pleading or a more definite statement from the customer.

Thereafter, arbitrators are assigned. FINRA Rules 12400-12403. Following a period for discovery and pre-hearing motion practice, and after the hearing on the merits, the arbitrators issue a written award.

III. FINRA Rules do not require the arbitrators to specify any cause of action or legal theory in an award.

In issuing an arbitration award, FINRA Rule 12904(e) requires arbitrators to: identify the parties (and their representatives) and the arbitrators; state the number, dates, and location of hearing sessions; acknowledge that the arbitrators have read the pleadings and materials submitted by the parties; summarize the issues; state the damages and relief the parties requested; state the damages and relief awarded; allocate the forum fees between the parties; and sign the award.

Rule 12904(f) says arbitrators *may* include a rationale in an ordinary award if *they* choose, but does not require them to do so. *See also United Steelworkers of Am. v. Enter. Wheel & Car Corp.*, 363 U.S. 593, 598 (1960) ("Arbitrators have no

obligation to the court to give their reasons for an award."). FINRA Rule 12904(g) requires an arbitrator to issue an explained decision if all parties jointly request that they do so. In such a case, the award must state "the general reason(s) for the arbitrators' decision. Inclusion of legal authorities and damage calculations is not required." FINRA Rule 12904(g)(2).[5]

Here, the customers and IB agreed to submit their disputes for decision by FINRA arbitrators, and agreed to abide by FINRA Rules in doing so.[6] The parties in this case did not jointly request that the arbitrators issue an explained decision. Therefore, the arbitrators issued the award containing the components required by Rule 12904(e). As the trial court recognized, the initial award was not an "explained decision." *Interactive Brokers LLC v. Saroop*, 279 F. Supp. 3d 699, 706-07 (E.D. Va. 2017), *appeal dism'd*, 2017 WL 8751822 (4th Cir. Dec. 12, 2017) (the initial award was "not a reasoned one in the usual meaning"). The trial court also recognized that the modified award issued at the court's request changed little from

[5] Even if the arbitrators here were required to issue a reasoned award, "courts have not recognized a failure to do so as a ground for vacating an arbitrator's award." *U.S. ex rel. Coastal Roofing Co. v. P. Browne & Assocs., Inc.*, 771 F. Supp. 2d 576, 583 (D.S.C. 2010).

[6] IB agreed three times—first when it joined FINRA as a member firm, second when it accepted the customers' signatures on its account agreement, and third, when it signed the FINRA Dispute Resolution Uniform Submission Agreement. Filing 1-12 at CM/ECF p. 905-910.

the initial award. *Interactive Brokers LLC v. Saroop*, No. 3:17-cv-127, 2018 U.S. Dist. LEXIS 214023 at *12 (E.D. Va. Dec. 19, 2018).

IV. Courts may only vacate arbitration awards in limited circumstances.

Given the important national policy choice to favor arbitration and the virtue it advances of speedy, efficient dispute resolution, courts can vacate arbitration awards only in very limited circumstances. *See Hall Street Assocs*, 552 U.S. at 581. Otherwise, arbitration would be simply a step in a protracted judicial process; the parties would lose their bargained-for benefits of arbitration. *Wachovia Sec.*, 671 F.3d at 478, n.5 (allowing "probing" judicial "review of arbitral awards would risk changing arbitration from an efficient alternative to litigation into a vehicle for protracting disputes"); *see also Oxford Health Plans LLC v. Sutter*, 569 U.S. 564, 568-69 (2013) (arbitration would become more cumbersome and time-consuming).

When a court analyzes a petition to vacate, the court should decide whether the arbitrators did their job—not whether they did the job well or correctly, or even reasonably. *Wachovia Sec.*, 671 F.3d at 478. The court decides whether the arbitrators reached a resolution to an issue within the scope of the disputes the parties agreed to arbitrate. *Id.*; *Raymond James Fin. Servs. v. Fenyk*, 780 F.3d 59, 68 (1st Cir. 2015) ("limited review of arbitral decisions requires us to uphold an award, regardless of its legal … correctness, if it draws its essence from the contract that underlies the arbitration proceeding" (citation and quotes omitted)). As DOMKE ON

COMMERCIAL ARBITRATION says, the focus for a court reviewing an arbitration award is "on whether the arbitrators had authority to reach a[n] issue, not whether the issue was correctly decided." Martin Domke & Gabriel Wilner, 2 DOMKE ON COMMERCIAL ARBITRATION § 39:13 (Thomson Reuters 3d ed. 2018).

"To vacate an award on the ground that the Panel manifestly disregarded the law, 'there must be some showing in the record, *other than the result obtained*, that the arbitrators knew the law and disregarded it." *Brown v. Rauscher Pierce Refsnes, Inc.*, 994 F.2d 775, 785, n.7 (11th Cir. 1993) (emphasis added; quoting *O.R. Securities v. Prof'l Planning Assocs., Inc.*, 857 F.2d 742, 747 (11th Cir. 1988)). The moving party must show that the arbitrators had actual, subjective knowledge of a legal rule that controlled the outcome, *T.Co. Metals, LLC v. Dempsey Pipe & Supply, Inc.*, 592 F.3d 329, 339 (2d Cir. 2010) (must be "a subjective element, that is the knowledge actually possessed by the arbitrators") (internal quotes and citations omitted); and then that the arbitrators "explicitly disregarded" that controlling rule. *THI of N.M. at Vida Encontada, LLC v. Lovato*, 864 F.3d 1080, 1088 (10th Cir. 2017) (party seeking vacatur must show "that the arbitrator 'knew the law and explicitly disregarded it"') (quoting *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925, 932 (10th Cir. 2001)). *See also, e.g., Long John Silver's Restaurants, Inc. v. Cole*, 514 F.3d 345, 349 (4th Cir. 2008) (requiring that the arbitrator was aware of the law, understood it correctly and found it applicable, and chose to ignore it); *Stolt-Nielson*

S.A. v. AnimalFeeds Int'l Corp., 559 U.S. 662, 670, n.3 (2009) (assuming "standard . . . requiring a showing that the arbitrators 'knew of the relevant [legal] principle, appreciated that this principle controlled the outcome . . . , and nonetheless willfully flouted the governing law . . .'").

If the arbitrators simply made an error in deciding fact or law—even if the error is serious—a court cannot vacate their award. *Stolt-Nielson S.A.*, 559 U.S. at 671 ("an error—or even a serious error" is "not enough"); *Fenyk*, 780 F.3d at 67 ("we may not disturb" an award that left court "perplexed, and may have been erroneous").

V. The arbitrators did not manifestly disregard the law.

When IB opted for arbitration as its preferred mechanism for dispute resolution, it traded away the opportunity for judicial review for legal errors, choosing instead the simplicity, informality, and expediency of arbitration. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 31 (1991). Under the applicable standards, the trial court had no basis to vacate the award in this case.

Here, the trial court noted that IB submitted briefing to the arbitrators arguing that FINRA Rules do not provide a private right of action. 2018 U.S. Dist. LEXIS 214023 at *33-34. Not surprisingly, though, the customers also submitted legal briefing to the arbitrators citing legal authorities they contended supported their legal rights to recover from IB. *See* Filing 17 CM/ECF at p.226, n.9. The trial court

observed that the arbitrators said they read the written materials submitted to them by the parties. 2018 U.S. Dist. LEXIS 214023 at *34. That observation does not show the arbitrators knew that any particular rule unequivocally controlled the outcome of this case – and then disregarded that rule. At most, the arbitrators properly performed their job of deciding a legal issue submitted to them.

There is no indication in the record that the arbitrators *actually* knew that FINRA rules do not themselves give rise to a private cause of action. *Cf. Dawahare v. Spencer*, 210 F.3d 666, 670 (6th Cir. 2000) ("Dawahare points to nothing in the record that shows the arbitrators' awareness of the . . . law he alleges to be applicable"). Thus, the arbitrators did not *manifestly* disregard such (supposed) applicable law.

Moreover, it is also important to understand that, independently of what the parties submitted to the arbitrators, and despite the predictable refrain from the industry, *FINRA says customers can rely on rule violations to support arbitration claims*. According to FINRA's predecessor, in arbitration, "[y]ou do not have to have a claim that is cognizable under NASD rules." Fienberg Remarks to NASAA, *supra* note 1 above. Ms. Fienberg also said:

> *You can also assert in your arbitration claim violation of [FINRA] rules*. For example, suitability. There's no statutory claim for suitability. That's a [FINRA] rule. It's much easier to assert and then prevail [on that kind of claim].[7]

[7] *Supra* Note 1 (emphasis added).

VI. The trial court also erred in assuming the arbitrators' rationale.

The trial court also erred by concluding that the only possible predicate rationale for the arbitrators' award in favor of customers was the arbitrators' conclusion that IB violated FINRA Rule 4210. 2018 U.S. Dist. LEXIS 214023 at *21-24. The award does not say that IB's liability was based only on a violation of Rule 4210. As the trial court recognized, the award does not say it based the liability finding on *any* specific cause of action. *Id.* at 21.

Moreover, FINRA Rule 4210 is not the only plausible basis for the arbitrators' award. Perhaps the arbitrators found liability for the customers and against IB based on the widely recognized principle, as the customers argued, that FINRA rules can set a standard of conduct supporting liability under negligence, fraud, or breach of contract. The trial court itself acknowledged this principle. *Id.* at *29. Here (even though they did not need to use or identify a legal cause of action), the customers did plead negligence, breach of contract, fraud, and a violation of the state securities act in their statement of claim. *See* Statement of Claim ¶¶46-58, available at Filing 1-10 at CM/ECF p. 96-99. The arbitrators could have concluded that FINRA Rule 4210 was evidence of a standard of conduct supporting liability under any or all of those causes of action. The arbitrators could have found *both* that IB breached a contractual obligation or a duty of good faith or that IB was negligent *and* found that IB violated Rule 4210. Perhaps the arbitrators knew of statements by FINRA like

those by Ms. Fienberg that customers *can* base claims on FINRA Rule violations, concluding that contrary authority was not controlling.

Perhaps the arbitrators had some other basis for their award, one that the trial court, the parties, or PIABA never considered. In denying IB any recovery on its counterclaims, perhaps the arbitrators decided IB had not satisfied its burden of proof. Since the arbitrators did not state the rationale for their award, no one can say what the arbitrators considered or disregarded in reaching their award. As the trial court below observed in its first opinion in this case, when arbitrators do not explain their award, judicial review for manifest disregard "is impossible." 279 F. Supp. 3d at 707 (citing *O.R. Securities*, 857 F.2d at 747; *Dawahare*, 210 F.3d at 669).

The trial court miscited *O.R. Securities* and *Dawahare* 279 F. Supp. 3d at 707 (after citing *O.R. Securities*, "[t]he Court will therefore remand this award to the arbitrators …"). When *O.R. Securities* and *Dawahare* say an arbitration award with no explanation of the arbitrators' rationale makes review for manifest disregard *impossible*, they mean what they say: a court must deny a petition for *vacatur* of an award based on manifest disregard when the award states no rationale or explanation. *O.R. Securities*, 857 F.2d at 748; *Dawahare*, 210 F.3d at 669-71. At least one other district court in this Circuit has correctly applied this rule. *See, e.g., First Baptist Church of Glenarden v. New Mkt. Metalcraft, Inc.*, 2010 U.S. Dist. LEXIS 77238, *8-10 (D. Md. July 30, 2010) (with no explanation it is "impossible

for the court to conclude the arbitrator understood and correctly stated the law, but disregarded it" so court confirmed award) (internal quotes and citations omitted); *Impossible Choice Hotels Int'l, Inc. v. Felizardo*, 278 F. Supp. 2d 590, 596 (D. Md. 2003) ("[A]rbitrators are not required to explain their decisions. If they choose not to do so, it is all but impossible to determine whether they acted with manifest disregard for the law.").

As the Court said in *O.R. Securities*, when the arbitrators "declined to state reasons for their conclusions, *[t]his ends the inquiry*" into manifest disregard, and a request for *vacatur* must be denied. 857 F.2d at 748 (emphasis added). That is what should have happened in this case when the parties were before the trial court for confirmation of the initial award. It is what should have happened after the second award. It is what should happen now.

Whatever the arbitrators actually thought – but did not express – is irrelevant to both the trial court's and this Court's review. The arbitrators resolved a dispute squarely within the scope of what the parties agreed the arbitrators would decide. They did not say they actually knew any particular legal rule controlled the outcome, nor explicitly disregard such rule. There is a plausible logic under which the arbitrators could have reached their award without consciously intending to disregard a controlling legal rule. The Court can go no further in assessing an

arbitration award. *Cf. T.Co. Metals*, 592 F.3d at 339 ("barely colorable justification" requires confirmation).

This case is already an illustration of arbitration losing its benefits of speed and efficiency – based, in part, on rules that do not require either parties or arbitrators to specify causes of action. This case is already an illustration of a well-funded brokerage firm converting arbitration to protracted litigation. This case is what mandatory brokerage industry-administered arbitration should not be permitted to become.

VII. Courts do not have authority to reverse and render arbitrable claims.

Courts do not have authority under the Federal Arbitration Act ("FAA") to adjudicate the merits of claims subject to arbitration. 9 U.S.C. § 1 et seq.; *THI of N.M.*, 864 F.3 at 1083-84 ("courts are not authorized to reconsider the merits of an award …."; internal citations and quotes omitted). Certainly nothing in the text of the FAA authorizes a court to reverse and render the merits of a claim that has been decided by arbitrators. Even if a court believes the arbitrators erred, the arbitrators' decision "holds, however good, bad, or ugly." *Oxford Health Plans*, 569 U.S. at 573.

Deciding the merits of customers' arbitrable—indeed, already arbitrated—claims is what the trial court seems to have done in this case. The trial court explicitly vacated the award in favor of the customers, implicitly terminating the customers' claims against IB on the merits. The trial court also explicitly vacated the denial of

IB's counterclaims, and explicitly remanded the counterclaims to a new panel of arbitrators. 2018 U.S. Dist. LEXIS 214023 at *38-39.

This Court should state clearly that the trial court did not have authority to terminate the merits of the customers' claims. If this Court allows the trial court's *vacatur* of the award to stand in any part, then the entire case should be completely remanded back to the original arbitrators for a new award on all disputes.

CONCLUSION

For these reasons, the judgment of the district court should be reversed.

Dated: April 18, 2019

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CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(g), I certify the following:

This brief complies with the length limitations of Fed. R. App. P. 29(a)(5) because it contains no more than one-half the maximum length authorized by this Court's rules for a party's principal brief, excluding the parts of the brief exempted by Fed. R. App. P. 32(f). The brief contains 3,584 words.

This brief complies with the typeface requirements of Fed. R. App. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word 2013 in Times New Roman 14-point font.

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CERTIFICATE OF SERVICE

I hereby certify that on this 18th day of April, 2019, a true and correct copy of the foregoing was filed with the Clerk of the United States Court of Appeals for the Fourth Circuit via the Court's CM/ECF system, which will send notice of such filing to all counsel who are registered CM/ECF users.

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MIXED MEDIA FOR A SUCCESSFUL PRESENTATION

Hugh Berkson & Sam Edwards[1]

Introduction

There is a substantial body of scientific research devoted to the subject of how people learn, and whether they learn better via visual or auditoria media. It should come as no surprise to most legal tacticians, but the consensus among those who have conducted the research is that people: (1) process visual information more quickly than they do auditory information; (2) focus on color graphics more than they do black and white ones; (3) retain information gleaned from visuals longer than they do from oral presentations; and, (4) respond best to a mix of oral and visual presentation of information.

While this is hopefully not new information for most seasoned litigators, gaining a better understanding of *why* these things are true should help a trial lawyer use mixed media to the best advantage for his or her clients and cases.

Visual vs Oral Presentations

Those who have researched the subject of whether visual or oral presentations are more compelling weigh in favor of visual ones. Why would that be the case? First, there is a long history of humans using visual images. We have used pictures to record our experiences for 250 centuries, pictograms and ideograms for the next 20 centuries, and words for only the remaining 15 centuries.[2] Second, the majority of information we perceive is visual. In fact, approximately 90% of information the brain receives is non-verbal.[3] This tilt of information is not accidental, but rather hard wired into our systems in such a way that humans process visuals more quickly than they do text –60,000 times faster.[4] And, third, biology explains this huge disparity in learning as well our natural inclination towards visual information. In the human body, 40% of nerve fibers are linked to the retina.[5] Additionally, the part of the brain used to process words is small in

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[2] Dewan, Pauline, *Words Versus Pictures: Leveraging the Research on Visual Communication*, Partnership Vol. 10, No. 1 (2015); available at: https://journal.lib.uoguelph.ca/index.php/perj/article/view/3137.

[3] www.pixelo.net/visuals-vs-text-content-format-better/ (March 21, 2018).

[4] Gillet, Rachel, *Why We're More Likely To Remember Content With Images And Video*, Fast Company (Sept. 18, 2014; available at https://www.fastcompany.com/3035856/why-were-more-likely-to-remember-content-with-images-and-video-infogr (Referencing a 3M study).

[5] Jandhyala, Dana, *Visual Learning: 6 Reasons Why Visuals Are The Most Powerful Aspect of eLearning*, (Dec 8, 2017); available at: https://elearningindustry.com/visual-learning-6-reasons-visuals-powerful-aspect-elearning.

comparison to the part that processes visual images.[6] Humans can therefore: see images that last for 13 milliseconds; gain the sense of a visual scene in 1/10 of a second; and, register 36,000 visual messages per hour.[7]

Not only do we process visual information much faster that auditory, we also remember it much better. People remember up to 80% of the visual information they receive, i.e. pictures and graphs, compared to approximately 20% of what they only read.[8] One scientific study found that people had significantly better short-term recall of words they saw, rather than the words they heard, and that they enjoyed much better recall of short words compared with longer words.[9] That said, not all pictures are created equal, and neither are all words. Studies show that decorative images are not remembered as well as informative ones. So, in making presentation materials, making it "pretty" is not as important as making it informative. Additionally, concrete words are remembered better than abstract ones.[10] So, the prose you choose as a part of your presentation needs to be clear and unequivocal rather than poetic and interesting if it is to be remembered beyond the actual presentation.

As a result, it should come as no surprise that 65% of people are visual learners.[11] Drilling down further, it might surprise some that women tend to be more visually oriented than men.[12] Women are also more likely to face adverse consequences from learning style mismatches than are men.[13] Obviously, litigators want everyone to understand and remember their message. Knowing that presenting the message in a format half the population (or more) is unlikely find compelling or recall should serve as a powerful motivator to ensure that trial attorneys spend as much time on the format of the presentation as the information within it.

Most importantly, as with most things in life, combining things makes the experience better. For our purposes, people who tie images to words enjoy better recall.[14] Consider, for example, a study in which a number of second-year dance students were taught two dance phrases. Some were taught by presenting a video clip, and some were taught through verbal instruction. Each was recorded as they performed the material. They were then presented complementary information using the other modality and recorded again. Finally, they were recorded again 10

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[6] Kouyoumdjian, Haig, *Learning Through Visuals*, Psychology Today (Jul. 20, 2012); available at: https://www.psychologytoday.com/us/blog/get-psyched/201207/learning-through-visuals.

[7] Jandhyala*, Supra.*

[8] www.pixelo.net/visuals-vs-text-content-format-better/ (March 21, 2018).

[9] Hilton, Elizaeth, *Differences in Visuan and Auditory Short-Term Memory*, IU South Bend Undergraduate Research Journal, Vol 4 (2001); available at: https://scholarworks.iu.edu/journals/index.php/iusburj/article/view/19810.

[10] *Id.*

[11] Bradford, Wiliam C., *Researching the Visual Learner: Teaching Property Through Art*, The Law Teacher, Vol. 11 (Sep. 10, 2004); available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=587201.

[12] *Id.*

[13] *Id.*

[14] Kouyoumdjian, *Supra*.

days later. While observation produced a better result than did verbal instruction alone, completeness scores showed that recall was generally better after the second learning step, compared to the first alone.

The reason this combined approach is thought to be that the brain's architecture implies a perceptual parity between the senses – audition and vision. Cross-sensory integration occurs completely and early in the perceptual stream.[15] Put into English, words have a single code in the brain while visuals have two (visual and verbal – the word tied to the picture). Thus, given the two codes associated with the visual, the odds of recall are increased to a significant degree.[16]

> Communicating with both graphics and text is well suited to the way our minds work. Reed points out that "our cognitive abilities to comprehend, remember, reason, solve problems, and make decisions depend on a rich combination of words and images." Language itself rests on a foundation of visual thinking, and metaphoric language in particular is inextricably linked with visual images. Metaphors underlie abstract thinking "by mapping them onto concrete ides." In the unconscious mind, the verbal and visual are also inextricably linked. If we have different ways of communicating, it makes little sense to rely on only one.[17]

The overwhelming research therefore supports that the most effective presentation will include both a visual and an audible component, will rely primarily on shorter words, and will use concrete words more frequently than abstract ones. While all of these concepts seem intuitive to the seasoned litigator, it does not hurt to know *why* these concepts are true *how* best to incorporate them into a compelling presentation.

Caveats and Tips

There are a few things to keep in mind as an attorney contemplates using visual aids during the course of a legal presentation. First and foremost, a visual aid works only when the viewer can see it clearly. Small, cluttered text and images convey little to the person across the room suffering from poor visual acuity. The presenter is asked to keep the following in mind as the visual presentation is developed:

1. Use sans-serif fonts – they present better on screens and projectors. The ten most popular sans-serif fonts are: Apercu, Futura, Proxima Nova, Avenir, Brandon Grotesque, GT America, GT Walsheim, Circular, Gotham and Graphik.[18] The resolution inherent in video monitors and projectors does not do well with the small flourishes serif fonts feature on each character.

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[15] Bläsing, Bettina E., Coogan, Jenny, BLondi, Josè, and Schlack, Thomas, *Watching or Listening: How Visual and Verbal Information Contribute to Learning a Complex Dance Phrase*, Frontiers in Psychology (Nov. 30, 2018), available at: https://www.frontiersin.org/articles/10.3389/fpsyg.2018.02371/full.

[16] Dewan*, Supra.*

[17] *Id.* (citations omitted).

[18] https://www.typewolf.com/top-10-sans-serif-fonts

2. Do not litter graphs with unnecessary data or images. Plot only what is important. Furthermore, never use the "3D" charting options available in excel. The 3D effect only serves to confuse the image and force the viewer to re-imagine the chart in 2D to better compare the height of the various bars or positions of the various plot points/lines. A compelling chart also lacks unnecessary elements like outlines, gridlines, or backgrounds. The focus should be on the data alone.

3. Use the right chart for the right data. The following concepts help with choosing the correct type of chart:
    a. Bar charts are best for showing comparisons of categorical data; and,
    b. Line charts are best for tracking changes over time with continuous data.

4. Use the best layout for the chart you're using. The following concepts help:
    a. You are likely better off avoiding a legend and instead labeling each line, next to the terminus of that line on a line chart. The viewer therefore does not have to continue to move the eye from the bottom to the line to figure out the chart's meaning.
        i. Naturally, there are exceptions. High density charts, like scatterplots, get cluttered quickly when using labels.
        ii. If there are few categories, such as in bubble charts comparing two categories, a legend works better.
    b. Use descriptive titles. For example, rather than the title "Peterson Account Value," consider the tile "Excessive Trading Causes Peterson Losses." While it's possible the title could be considered as a dreaded example of "Telling not showing," the fact is that the chart itself will validate the title, making the entire image more compelling to the viewer.
    c. Use bright contrasting colors for important elements of the chart and soft muted colors to push less important elements into the background.
    d. Keep aspect ratios in mind when sizing the chart. Narrowing the width of a line chart will serve to make each increase or decrease in amplitude more dramatic.

An outstanding primer for effective charts, including examples proving each point, was prepared by Midori Nediger in 2018 and is readily available on the Web.[19]

Knowing your technology is also a vitally important component to effective presentations. If the presenting attorney decides to use a computer or tablet to assist with the visual elements of the presentation, they need to know how to use both the hardware and the software or at least make sure there is someone present to help who is intimately familiar with the hardware and software being used. A series of avoidable tech mishaps will derail even the best presentation. Spend the time necessary so using the hardware and software becomes second nature.

Finally, there is a persistent thought that a plaintiff's (or claimant's) lawyer shouldn't use high-tech presentation methods for fear of creating the wrong image in the fact-finders' minds. The concern is the feeling that the factfinder my believe the victim clearly has a lot of money – how else could they afford a lawyer with all that fancy technology? Fortunately, those fears are (mostly) misplaced. First, presentation technology has become fairly commonplace. There's no more "razzle dazzle" effect. Second, it is easy to defuse those concerns by addressing them at the outset. Years ago, one of the authors of this paper, Hugh Berkson, was representing a large

[19] Nediger, Midori, *10 Do's and Don'ts of Infographic and Chart Design* (May 14, 2018); available at: https://venngage.com/blog/chart-design/.

insurance company defending a bad-faith claim. Plaintiff's counsel was a defense lawyer who decided to change sides for this one case. Plaintiff was a court reporter and used her connections to bring a technology team into the courtroom to run the exhibits, computer, and projector. Mr. Berkson brought his associate to do the same. During the course of the opening statement, Mr. Berkson told the jury that he too would be using the computer and projector to display graphics and exhibits through the course of the trial. He introduced his tech team: his associate.

Mr. Berkson explained to the jury that he taught his associate everything he knew about the software and hardware and it was almost certain there would be tech hiccups along the way. Mr. Berkson asked the jury to blame him for those problems, since he was the one who trained his associate. Job complete – Mr. Berkson had completely undercut the whole "massive insurance company with infinite resources who won't care one bit about the result of the trial." To answer the question that's surely coming, yes, Mr. Berkson did get a jury award that was less than 1/20th of the Plaintiff's last settlement demand.

Conclusion

The goal of any trial or arbitration presentation is to convince the factfinder. Most litigators have learned through trial-and-error and anecdotal experiences. A survey of literature on the subject of learning styles reveals that litigators' gut instincts are correct: visual aids make a huge difference in the quality of a presentation. In fact, it is nearly certain that the factfinders will remember more, and will find more convincing, material they perceive through a visual medium. But, even then, the combination of auditory and visual messages is more compelling and easier to remember than either auditory or visual messages standing alone. A high-quality and compelling presentation will: (1) use simple images; (2) use short words; and, (3) focus on concrete rather than abstract words. Such a presentation will be more likely to be remembered, and more likely to be believed, than one that is not so structured.

BROKER/DEALER INSURANCE COVERAGE AND FINRA ARBITRATION[1]

Joseph R. Wojciechowski[2]

I. Introduction

The hunt for insurance liability coverage should be a paramount objective for every claimant's attorney. Because many FINRA brokerage firms are small, undercapitalized companies, any substantial arbitration award can result in it going unpaid. One way to ensure against this is to first determine whether any coverage exists and then figure out how to tap into those funds. In the arbitration world, this is easier said than done and for years has flummoxed attorneys representing investors. A proposal pending before the FINRA Board of Governors could forever change the claimants' bar in this regard: A rule change amending the FINRA Discovery Guide to make insurance coverage "presumptively discoverable". Still, the timing of the disclosure may not help in many cases. As such, it is critical that claimant-attorneys understand their Respondent and steps they can take to obtain information about coverage even before formally filing a Statement of Claim.

Also, as the broker/dealer space continues to shrink and migrate to the RIA space, PIABA attorneys' practices will increasingly involve bringing lawsuits or arbitration claims in forums other than FINRA. In those instances, the coverage issues could be even more precarious and important. The number of small RIAs with nominal assets under management and very little capitalization is likely to increase over the next decade making collectability an every-growing problem.

Once a claimant-attorney determines there is an insurance policy that might cover the client's claims, picking through the policy to determine exclusions is a skill that can require a healthy amount of skepticism and imagination. Insurance policies are intended to be limited and those liability policies that may be applicable in the claimant-attorney practice area, are typically riddled with more holes that a piece of swiss cheese. Just because it seems clear that your client's claims fall outside of coverage, do not give up on that pocket. Insurers owe their insureds a duty to defend which, depending on what state you are in, can be a very high duty.

Finally, you determine your client's claims are covered but the insurance carrier or the Respondent are not acknowledging it. This frustrating scenario could require you to sue the

[1]This article is incorporated into the 2020 PIABA Annual Meeting materials to accompany the breakout session to be held on Wednesday, October 23, 2020 at 1:30 p.m. which will be moderated by Mr. Wojciechowski, at which time Alexander Loftus, Esq., John S. Burke, Esq., Ohia Amadi, Esq., and William D. Nelson, Esq., will also be presenting a detailed presentation including the various particulars of liability insurance coverage as it relates to FINRA cases, RIAs, broker/dealers, and financial advisors. A special "thank you" to Alex Loftus for his assistance with preparing both this submission and the presentation to come.

[2] Mr. Wojciechowski currently serves is the former Editor-in-Chief of the PIABA Bar Journal and has been a PIABA member since 2009. He holds a BA Degree in Political Science from Western Michigan University and a Law Degree from the John Marshall Law School. He is licensed to practice in Illinois and has represented investors throughout the United States, Canada, and worldwide. He has been representing investors in arbitration, litigation, and class actions since 2009.

insurance company for a declaratory judgment. Be careful and read the policy for both choice of law provisions and arbitration clauses. Some of the most useless and worst arbitration provisions this author has encountered have been buried in insurance policies for investment advisers and broker/dealers.

II. Discoverability of Insurance Coverage Information

For many years, a primary concern for investors in securities arbitration has been the collectability of settlements and arbitration awards. There is no worse scenario than going through the arbitration process, winning an award, and then have the respondent welch on paying the award. Of course, any FINRA member firm or associated person that fails to pay an award can face summary suspension of their licenses by FINRA. Further, pursuant to FINRA Rule 1014(a), a new member application can be "presumptively denied" if the applicant or its associated persons are the subject of unpaid awards.

One of the ways a member firm or an associated person could survive an arbitration award is liability insurance coverage. Of course, the firm would need to 1) have some form of coverage; 2) the conduct at issue would have to fall within the limitations of the coverage; and 3) the firm would have had to timely notify the insurance carrier and pay its deductible. This all sounds sensible, but sometimes firms and brokers are their own worst enemy and fail to adhere to the notification requirements of the policy which can lead to a denial of coverage.

Importantly, and to the eternal frustration of PIABA lawyers, there are no rules at the state, federal, or industry levels that mandate member firms or associated persons maintain even a minimal level of coverage. The same goes for RIAs. Whether the RIA manages $10 million or $1 billion dollars, there is no law requiring liability insurance coverage. One could make a compelling case that failing to maintain any level of liability insurance coverage is foolish. Some trade and marketing associations in the insurance business do require their members and agents carry some form of liability coverage for this reason.

Even if a FINRA member firm or associated person has liability coverage, there is nothing compelling the production of that information. In the author's anecdotal experience, it is exceedingly rare for brokerage firms to ever admit there is any insurance coverage. Usually, experienced practitioners can deduce the existence of coverage based on which defense firm represents the respondents. Also, if a case reaches mediation, the mediator usually shares whether there is applicable coverage. Not only do firms not share the existence of coverage willingly, they (wrongly) believe it is in their company's best interest not to share that information lest the jackals start blogging about them.

One story the author can relay is both relevant and disconcerting. In a case involving an independent B/D and an alternative investment product, I was mistakenly copied on an email string between opposing counsel and the carrier. I was surprised there was coverage of any kind actually. Their exchange was rapid, so I had been copied on several messages before I could alert them that I was mistakenly copied. The attorney for the carrier was explicit in her badgering of respondent's counsel, and specifically stated "now they know the firm has coverage" feeding directly into their conspiracy theory that knowledge of coverage will lead to an avalanche of claims as opposed to the misconduct of their unsupervised brokers. In my view, this was an immature, unsophisticated, and shortsighted approach.

The inability to discover the existence of liability insurance coverage is unique to arbitration. In civil cases filed in federal court the disclosure of coverage information is an initial disclosure under FRCP Rule 26(a)(1)(A)(iv). The rule provides that "a party must, without awaiting a discovery request, provide to the other parties for inspection and copying as under Rule 34, an insurance agreement under which an insurance business may be liable to satisfy all or part of a possible judgment in the action or to indemnify or reimburse for payments made to satisfy the judgment." Because of the edict to supplement Rule 26 disclosures pursuant to FRCP Rule 26(e)(1)(A), some courts have held that additional information about the policy, like updating the amount existing under the policy, is also discoverable. *See In re DelMarine, Inc.,* 535 F.Supp.2d 318 (E.D.N.Y. 2007). Other courts, however, disagree that the supplemental disclosure language of Rule 26 is sufficient to compel the production of additional policy information. *See Excelsior College v. Frye,* 233 F.R.D. 583, 586 (S.D. Cal. 2006).

The discoverability of insurance policy and coverage information has been a done deal in federal court for many years. Although this submission is by no means an exhaustive run on what states similarly require the disclosure of liability insurance coverage information at the outset of litigation, most states seem to follow the guidance of the federal rules in this regard. In Illinois, Supreme Court Rule 222(d)(8) requires the prompt disclosure (within 120 days of the filing of a responsive pleading), of "[t]he existence, location, custodian, and general description of any tangible evidence or documents that the disclosing party plans to use at trial and relevant insurance agreements." Furthermore, the prompt discovery of coverage information also finds support in the form interrogatories listed in Illinois Supreme Court rule 213(J). Although the form interrogatories were eliminated as of January 1, 2018, Illinois still stands firmly for the prompt disclosure of insurance policy information. The discovery of insurance policy information is also the law of the land in the State of California (*see CCP § 2017.210)*; New York (*see N.Y. Ins. Law §§ 2601* and *3420*); and Florida (*see Florida Rules of Civil Procedure, 1.280(b)(2)*).

The reason why insurance policies and other information related to indemnity are promptly discoverable in civil litigation, and not in arbitration suits, is obvious on its face. These states and the federal court system have codified these disclosures making them a requirement. There are no similar rules governing the prompt discovery of insurance policy information in any familiar arbitration forum. The AAA has no insurance policy disclosure requirement under either the Consumer Rules or Commercial Rules. The JAMS Rules similarly contain no provision for the automatic disclosure of insurance policy or other indemnification agreements. Of course, there is no rule in FINRA Arbitration either – but that day is coming soon.

For practitioners finding themselves in non-FINRA ADR forums, like AAA or JAMS, there is broad discretion given the parties in designing the limitations of discovery and procedural rules. Especially in JAMS, where all of the arbitrators are retired state and federal court judges, they crave procedural consistency, so it is common for parties to stipulate, for example, to rely onthe procedural law of a particular state, say Illinois, during the case. Such a stipulation could require the prompt disclosure of insurance policy information, but be careful, because it could also lead to broad discovery like interrogatories and depositions. Still, through the use of these stipulations in non-FINRA ADR forums, a practitioner could likely gain access to that important coverage information.

FINRA practitioners know this scenario is highly unlikely in FINRA cases, and as such, have to rely on motions to compel to gain access to policy information. As routine as it is in court, FINRA arbitrators are typically reluctant to order the production of policy information in the face of Armageddon-like opposition from respondent-Counsel. But things may finally be changing in

FINRA and could become the first substantial arbitration forum to make the discovery of policy information a routine disclosure.

III. FINRA Regulatory Notice 18-22 And the Discovery of Policy Information in FINRA Arbitration.

On July 26, 2018, FINRA delivered Regulatory Notice 18-22 titled "Discovery of Insurance Information in Arbitration." The notice provides that FINRA sought to amend the Discovery Guide Document Production List 1 to require firms and associated persons – upon request – to produce documents concerning third-party insurance coverage. The Notice was the culmination of the Dispute Resolution Task Force which issued a report in December 2015.

The Notice identifies the primary purpose advocated by claimant-lawyers in support of the discovery of policy information as being important to investors and their litigation strategy. *RN 18-22* at 2. This of course, is true and quite obvious. Without knowing whether a respondent may be insured is akin to flying blind. The Respondent-side complains that the insurance information will find its way to the arbitrators and would be prejudicial – of course because arbitrators are more likely to render an award if they believe it will be covered by insurance. *Id.* at 3. This seems disingenuous, but rules of evidence nationwide specifically state coverage information, including its mere existence, is generally not admissible as evidence of negligence or fault at trial. *See FRE 411.* The industry also objected to having coverage information disclosed automatically in all cases, setting the stage for motion practice. *Id.*

Through RN-18-22, FINRA seeks to amend List 1 of the Discovery Guide, adding the following:

> 23(a) If requested, the firm/associated persons shall produce documents sufficient to provide details concerning coverage and limits of any insurance policy under which any third party insurance carrier might be liable to satisfy in whole or in part an award issued by an arbitrator in the subject arbitration proceeding or to indemnify or reimburse a party for payments made to satisfy an award.
>
> (b) It may be prejudicial for arbitrators to be given information related to the coverage or lack of coverage by liability insurance. Therefore, any party wishing to submit evidence at the hearing relating to insurance must demonstrate to the arbitration panel that: (1) there are extraordinary circumstances warranting admission of the insurance information; or (2) the existence of an insurance policy is directly related to the dispute outlined in the statement of claim. The party must seek express authorization from the arbitration panel to submit the evidence.

See FINRA RN 18-22 at 9.

In the notice, FINRA expressly addresses certain important limitations about the scope of this proposed List Item. First, the proposed amendments would not require the production of documents in connection with self-insurance. More importantly, there is nothing automatic about the disclosures. Pursuant to FINRA Rule 12506, documents and information responsive to the List Items are to be produced no later than sixty days from the date the answer to the statement of claim is due. That directive does not apply to Item 23. The Claimant must request the discoverable information identified in 23a, which puts the onus on claimant's counsel to request this information as soon as possible.

FINRA's reasoning for this was essentially to appease the industry which expressed a concern that that "firms with sufficient capital to pay arbitration awards should not be required to produce insurance information automatically in every arbitration case." *Id.* at 3. Although insurance information may not be important for what one may consider to be "well capitalized", therein lies the challenge. From case to case, it can be difficult to determine whether a member firm is in fact "well capitalized" or whether a once well-capitalized firm is under siege and has 200 claims pending against it, facing millions in liability. To a substantial degree, we operate in the dark about this sort of information which is why the policy should be provided automatically. Obviously, this is not a concern with Merrill Lynch or other large, bank-backed wire house firms.

Second, 23a does not identify specifically what respondent is required to produce. It fails for want of specificity. It does not say respondent must produce the applicable insurance policy. It does not say declination or reservation of rights letters must be provided. The notice is too easily interpreted and will leave attorney's jousting over something that FINRA could have made clear, like FRCP 26. However, it is a start. Because these proposed amendments garnered a lot of attention, the comment period was extended to November 2018. Despite strong opposition from the industry, it appears as if these amendments to the Discovery Guide will eventually be passed by the Board of Governors and then approved by the SEC. When that will happen in the age of COVID is anyone's best guess. Upon information and belief, the Board of Governors was still considering the amendments and once approved, will then need to be approved of by the SEC, so this may take some time still. But practitioners would be wise to begin planning for this now and prepare for what steps to take and what to do with policy information in-hand.

IV. Now you Have the Insurance Policy, What do you Do Next?

You have successfully wrestled the applicable insurance policy from Respondent. Now what do you do? The first step is to find out if Respondent has alerted the carrier about your claim. You need to know what the Respondent told them and what the carrier's response was. Did Respondent simply forward a copy of the Statement of Claim? Or did they send the carrier a memo putting your clients' claims in their own words? It is highly unlikely Respondent will produce their communications with the carrier, especially any memoranda about the claims. However, any correspondence from the carrier to the insured, whether it be a "reservation of rights" letter or a flat out "declination" letter, should be requested and provided so that there is an understanding about where the carrier stands.

The difference between what are regularly referred to as a "reservation of rights" letter and a "declination" letter is critical. A "reservation of rights" letter is generally speaking, a notice from the carrier to the insured informing the insured of the reasons why the carrier will not admit outright the claims are covered, but will at a minimum provide the defense required by the policy. On the other hand, a "declination" letter is a notice from the carrier that it not only deems the claims to

be not covered by the policy, the claims fall so far outside coverage, that the carrier will not even provide a defense. Carriers can get into trouble with declination letters, so they are not nearly as common as the reservation or rights letter. Denying an insured a defense can lead to a bad-faith claim against the carrier which can result in the carrier owing more than the policy limits potentially, so carriers are wise to deny a defense sparingly.

Once claimant-counsel gets the lay of the land insofar as where the insured and the carrier stand, now the policy terms themselves need to be dissected. First, what are the coverage limits and will your claim's best-case scenario fall within them? Obviously, the larger your claim, the more important this is. This first step is critical. If you have a large case – say a NOP of $1.5 million – and the coverage limit is $1 million, it may behoove you to make a coverage policy limit demand directly to the carrier. There are several reasons for this. First, if your client's claim is arguably covered by the policy, and the amount of the claim is in excess of the policy limits, a policy coverage demand triggers a duty by the carrier to strongly consider paying the policy if it would settle the case.

Under Illinois law, insurance carriers have a duty of good faith and fair dealing to their insureds where recovery may exceed insurance policy limits. *Cernocky v. Indemnity Insurance Company of North American*, 69 Ill. App. 2d 196, 216 N.E.2d 198 (2nd Dist. 1966). This duty arises in the context of an insurance policy in which the insurer reserves the right to settle claims made under the policy and to conduct settlement negotiations. *Id.* Once there is a demand to settle a case within policy limits, an insurer must give the interests of the insured at least equal consideration with its own interests. A failure to do so would be bad faith. *See Adduci v. Vigilant Insurance Company*, 98 Ill. App. 3d 472, 424 N.E.2d 645, 648 (1st Dist. 1981).

The duty owed by the carrier to settle arises by making this demand to settle within the policy limits and there is (1) a reasonable probability of recovery in excess of policy limits; and (2) a reasonable probability that the court will find the insured liable for the claim. *Haddick v. Valor Insurance*, 198 Ill. 2d 409, 417, 763 N.E.2d 299, 304 (2001). The Illinois Supreme Court explained this point as follows:

> An insurer derives the authority to engage in settlement negotiations from the language of the insurance contract. Generally, such language gives the insurer the right to "make such investigation, negotiation, and settlement of any claim or suit as it deems expedient." Therefore, the basis for the duty to settle is the insurer's exclusive control over settlement negotiations and defense of litigation. This exclusive control, however, necessarily results in a conflict of interest between the insurance provider and its insured. We explained in *Cramer* that: "In the typical 'duty to settle' case, the third party has sued the policyholder for an amount in excess of the policy limits but has offered to settle the claim against the policyholder for an amount equal to or less than those policy limits. In this circumstance, the insurer may have an incentive to decline the settlement offer and proceed to trial. The insurer may believe that it can win a verdict in its favor. In contrast, the policyholder may prefer to settle within the policy limits and avoid the risk of trial. The insurer may ignore the policyholder's interest and decline to settle." In such cases, the insurance contract itself does not provide a remedy to the insured faced with a judgment in excess of policy limits; therefore, the law imposes upon the insurer the duty to settle in good faith.

Haddock at 414-15. (Internal Citations Omitted)

The duty to settle is triggered with a policy limits demand. *Haddick*, 198 Ill. 2d at, 413. ("[T]he same threat exists to the policyholder that the insurer will wrongly refuse to settle within the policy limits and a judgment will be entered against him in excess of the policy whether the third party attempted to negotiate a settlement prior to or after filing suit." *Id.* (emphasis added). Furthermore, the Illinois Supreme Court held the plaintiff could maintain her cause of action for bad faith even though she revoked her offer to settle within the policy limits prior to filing suit. *Id.*

In *National Union Fire Ins. Co. v. Continental Illinois Corp*., 673 F. Supp. 267, 270 (N.D. Ill. 1987), Judge Shadur held a claimant could pursue excess from the insurer after entering into a settlement agreement with the insured for an amount in excess of the policy limits.

Judge Shadur reasoned:

> Illinois has long recognized an insured's right to hold the insurer responsible for an amount in excess of the policy limits when the insurer has been guilty of fraud, bad faith or negligence in refusing to settle the underlying claim against the insured within those limits (*see, e.g., Olympia Fields Country Club v. Bankers Indemnity Insurance Co*., 325 Ill. App. 649, 60 N.E.2d 896 (1st Dist. 1945)). Because an insurer generally does not have an absolute duty to settle a claim against its insured, cases such as *Scroggins v. Allstate Insurance Co*., 74 Ill.App.3d 1027, 1029, 393 N.E.2d 718, 720, 30 Ill. Dec. 682 (1st Dist. 1979). Accordingly, in Illinois there is imposed upon the insurer a duty, part of the implied-in-law duty of good faith and fair dealing arising out of the insurance relation, to give to the insured's interests consideration at least equal to that of its own in such a case. When an insurer breaches that duty by refusing to settle it may be liable for the full amount of a judgment obtained against its insured, irrespective of its policy limits.

National Union Fire Ins. Co., 673 F. Supp. at 270.

The Northern District of Illinois held, "Illinois law allows an insured to effect a reasonable settlement on its own after the insurer has breached the duty to settle (*Krutsinger v. Illinois Casualty Co*., 10 Ill.2d 518, 527, 141 N.E.2d 16, 21 (1957)), just as after the insurer has breached the duty to defend (*Thornton v. Paul*, 74 Ill.2d 132, 144-45, 384 N.E.2d 335, 340, 23 Ill. Dec. 541 (1979))"… If a settlement was available within the policy limits and the insurer's breach of the duty to defend frustrated that settlement, there would appear to be no principled distinction between a later excess judgment for the insured and a later excess settlement made by the insured reasonably and in good faith. In each instance the breach would have triggered the excess liability. When an insurer breaches only its duty to settle, it may be argued the insured should not be allowed to settle on its own because the insurer still has legitimate interests in preventing or mitigating its liability by forcing a trial (*see Fireman's Fund Insurance Co. v. Security Insurance Co. of Hartford*, 72 N.J. 63, 367 A.2d 864, 873-77 (1976)" *National Union Fire Ins. Co,*, 673 F. Supp. At 271.

In these circumstances, at least in Illinois, the law is clear. Importantly, this scenario is probably pretty rare – it is not every day a claimant-lawyer has a legitimate damage claim for more than a million dollars against a firm that has both capitalization concerns and applicable coverage. Yet, it does happen and the properly schooled practitioner will understand how to leverage the law and a proper settlement demand to inure to the best interests of their clients.

a. My Client's Claims Do Not Fit Neatly Into the Covered and Excess Box.

Assuming the claim does not fit neatly into coverage and is not worth substantially more than the coverage limits, the policy coverage limits, the exclusions, endorsements, and definitions will have to be examined in detail. This is where contract law and interpretation takes center stage. Attached hereto as **Exhibit 1** is an actual insurance policy for an unnamed former FINRA member firm. A review of this policy indicates its true limitations, which are pretty dauting, especially if you are not used to reading, analyzing, and researching these policies. It contains many common exclusions found in broker/dealer policies like 1) the policy only applies to account owners; 2) the policy excludes specific types of products and specific types of frauds. Right off the bat, if the claimant did not have an account at the firm – importantly it is not a distinction between whether the claimant is arguably a "customer" as defined by FINRA Rule 12200 – then the claimant's claims are likely not covered. Moreover, this policy excludes a thorough list of investment products and claims, including:

- Commodities, commodity futures contracts, any type of option contract or derivative;
- Penny-stocks/pink-sheet stocks
- Foreign securities
- Annuities specific to structured settlements
- Viatical settlements
- Limited Partnerships, REITs, promissory notes, equipment leases, promissory notes
- Hedge funds
- TICs
- Auction rate securities
- Outside business activities

Other common exclusions include "insolvency" – meaning arguably if the claimant's damages arose from the bankruptcy or insolvency of a company, the claim is excluded. Although not terribly relevant to this discussion, class action claims are regularly excluded from coverage.

If a claimant's claim falls within one of these many exclusions, it does not mean the claim cannot be covered. It just means the carrier may require a bit of an education before it submits to settlement. There is a substantial amount of case law that holds where an alleged proximate cause of the claimant's injury is covered, the insurer must indemnify even if another proximate cause is not covered.

Precedent establishes that damages that can be decoupled from the underlying exclusion, are covered. In *United States Fidelity & Guaranty Co., v. State Farm Mut. Auto. Ins. Co.,* 152 Ill. App. 3d 46 (1st Dist. 1987), the Court examined a clause that excluded coverage for bodily injury arising from the maintenance, ownership, operation or use of an automobile. The injured

party brought a personal injury claim against a daycare center for injuries to a child sustained when an employee of the daycare was transporting children from the daycare facility to a dance class. The claim was brought by the injured child's parents and alleged negligent failure to supervise along with negligent operation of a motor vehicle. They alleged that a proximate cause of the child's injuries was the failure to operate and maintain the station wagon properly. USFG argued the claim was clearly excluded from coverage because the injuries to the child resulted from the use or operation of the station wagon and because the injuries could not have occurred without the operation or use of the station wagon. *Id.* at 48.

The jury returned a verdict for the parents and USFG appealed arguing the claim was excluded. The First District disagreed with USFG, stating "USFG's argument overlooks the fact that there may be more than one proximate cause of an injury….If a proximate cause of an injury is within the included coverage of an insurance policy, the included coverage is not voided merely because an additional proximate cause of the injury is a cause which is excluded under the policy. Thus, in order for an injury to be excluded from coverage under an insurance policy, the injury must have been caused solely by a proximate cause which is excluded under the policy. *Id.* at 48- 49.

The court determined that the record did not establish the sole proximate cause of the child's injuries was the use, operation, or maintenance of the station wagon. Rather, one of the proximate causes of the injuries was the failure to supervise the children. *Id.* Because there was more than one proximate cause for the injury, and it was covered, the exclusion did not bar recovery.

In *Continental Cas. Co. v. McDowell & Colantoni, Ltd.*, 282 Ill. App. 3d 236 (1st Dist. 1996), the court again considered an exclusionary clause in a liability insurance policy and construed it against the insurer. At issue in that case was an exclusion for covering claims involving fraud, dishonesty, deceit, or criminality. The underlying claim involved an attorney who misappropriated funds from the law firm trust account. The trial court ruled for the insurance company on summary judgment and the law firm/clients appealed. The court cited to the *USFG* decision in overturning the trial court's grant of summary judgment.

It also distinguished *Transamerica Insurance Co. v. South*, 975 F.2d 321 (7th Cir. 1992) as being "of very little precedential value, since . . .Illinois courts may not adhere to [it] in the face of the Illinois rule of *contra preferentem* (strict construction against the drafter of the policy)." *Id.* at 244. It also disagreed with the core conclusions of the Seventh Circuit in *Transamerica* which stated the *USFG* case was limited by *Allstate Ins. Co. v. Pruitt*, 177 Ill. App. 3d 407 (1st Dist. 1988) to "cases in which the two causes of injury are wholly independent of on another." Instead, the court reaffirmed *USFG* stating "nothing in the facts, the policy there reported, or in the *Pruitt* opinion itself makes such an overarching statement." *Id*. at 243.

In overturning the trial court, *Continental* relied on *USFG,* holding the underlying claims were not seeking recovery based on the excluded criminal acts, but rather, the negligence of the law firm in failing to adequately supervise and monitor the trust account. Continental argued "there could be no loss unless the excluded dishonest event occurred, and that causation should play a fundamental role in determining the applicability of exclusions." The court disagreed, reasoning that "but for" the law firm's negligent supervision of the trust accounts, which began some time before the misappropriation of the funds, the dishonest act would not have occurred if the law firm had supervised the accounts properly. *Id.* at 244. The law firm's negligence was independent from the misappropriation. The court provides further useful analysis regarding this causal analysis, linking it the general concept that in determining whether an exclusion applies

the court must construe the provision liberally in favor of the insured and "most strongly against the insurer."*Id.* at 245.

Generally, the law in California establishes that policy exclusions must be construed narrowly and against the insurers. "To protect the interests of the insured, coverage provisions are interpreted broadly, and exclusions are interpreted narrowly." *Mackinnon v. Truck Ins. Exchange*, 31 Cal. 4th 635, 638 (2003). Further, a policy provision will be considered ambiguous when it is capable of two or more constructions, both of which are reasonable. *Bay Cities Paving & Grading, Inc. v. Lawyers' Mutual Ins. Co.*, 5 Cal. 4th 854, 857 (1993). "Language in a contract must be construed in the context of that instrument as a whole, and in the circumstances of that case, and cannot be found to be ambiguous in the abstract." *Bank of the West v. Superior Court*, 2 Cal. 4th 1254, 1265 (1992).

When analyzing coverage and determining whether there is even a duty to defend, the insurer looks to the bare allegations of the complaint and any extrinsic facts available to it at the time of tender. *See, e.g. Waller v. Truck Insurance Exchange*, 11 Cal. 4th 1, 25-26 (1995). *See also, Monstrose Chemical Corp. v. Superior Court*, 6 Cal. 4th 287, 295 (1993) (determining whether there is a duty to defend turns upon "those facts known by the insurer at the *inception* of a third-party lawsuit.") (emphasis in original); and *North Counties Engineering, Inc. v. State Farm General Ins. Co.*, 224 Cal. App. 4th 902, 927 (1st Dist. 2014) (stating "[t]he availability of liability benefits is scrutinized in light of the insurance contract as a whole, the allegations of the underlying complaints in their entirety, the universe of facts as they existed at the time of tender, and common sense.")

The analysis above can make or break coverage in cases involving fraud or even criminality, where the allegations make clear that "a proximate cause of the claimant's injury" was the broker/dealer's negligent supervision. It does not have to be the only proximate cause, just one of them, in order to trigger coverage. Moreover, it is important to rely on contract law standards and as remember that exclusionary language will be strictly construed against the insurance company.

b. You Win Your Client's Case, or Settle with the Brokerage Firm But the Carrier Will Not Honor the Award or the Settlement.

If you have either settled with the brokerage firm or gone to an award and the insurance company refuses to honor either based on reservation of rights or a flat-out declination, you will have to take on the insurance company through some sort of declaratory judgment action. Again, look to the policy for important information specific to this sort of action. Policies typically include a choice of law provision, and all too often use New York law which is far less favorable to insureds than Illinois or California law, which tend to be more insured-friendly. There could be choice of forum provisions too that could render the declaratory judgment complaint you prepared to file in Cook County, Illinois useless.

Another provision finding its way into liability insurance policies are arbitration provisions. It has been common for years for small policy coverage disputes, especially in the automotive coverage field, to be resolved via arbitration. These provisions are finding their way into E&O policies for brokerage firms and RIAs. The author has seen two recently that could not have been more different, and could not have been more onerous on the insured/claimants. The first arbitration provision called for non-binding arbitration of all coverage disputes in front of an arbitrator in Palo Alto, California – likely the most expensive place to do anything in the United States. What this arbitration provision meant, quite literally, is the parties would be forced into an

extremely expensive private arbitration with an arbitrator in Palo Alto, California. Whatever the decision of that arbitrator, however, would be non-binding on the parties, rendering it useless. No matter what happened in that arbitration, the parties were going to end up in state or federal court to litigate the coverage questions. There could not be a more intentionally drafted arbitration provision designed to both waste the policy and waste the claimant's resources.

The second provision called for binding arbitration through the AAA Commercial Rules, with a panel of three arbitrators, to be heard in New York, New York. On balance, this AAA clause could not be more expensive, but at least the decision would be binding on the parties, subject to the Federal Arbitration Act, 9 U.S.C. § 1, *et seq.* AAA Commercial rules require the parties to split arbitrator fees and three arbitrators in New York would cost many thousands of dollars each to take to a decision. The advent of arbitration provisions in coverage disputes creates an opportunity however for those practitioners more used to representing clients in arbitration as opposed to more traditional civil litigation.

c. When Drafting your Statement of Claim, Understand Your Target and Attempt to Determine Coverage Before Filing.

In a perfect world, all claims would be against self-insured behemoths where collectability is not a concern. You can draft claims with the most nefarious facts, alleging intentional misconduct, fraud, and conversion and never have to worry about pleading your client's case out of coverage. Well, the world is far from perfect, and as the investor representation practice continues to move away from large brokerage firms and into the smaller broker/dealer/RIA space, carefully pleading your client's case is more important than ever. It is imperative that these claims be drafted responsibly. Every lawyer has had that conversation with their client after you send a draft of a statement of claim and it is limited to negligence and breach of fiduciary duty claims. The clients demand to know why you didn't make any statutory claims. Where are the fraud claims? Why didn't you include all of those nefarious facts establishing what a crook the financial advisor is? Educate your clients on the front end that your job is to put their case in the best position to secure a recovery for them, not to write statements of claim full of thunder and lightning.

Although RN 18-22 proposes to make liability insurance policies discoverable, it is quite possible, if not likely, that the unwary investor-advocate has already filed a complaint that gives the insurer all of the reasons it needs to deny coverage. To stay out in front of this scenario, there are a few different approaches to take. One step that can prove invaluable to your client's case is, before filing a statement of claim, to reach out to the respondent and request insurance policy information. Be careful to keep the language of the letter simple because the carrier will use every piece of information it can to deny coverage. It does not work most of the time, but occasionally, the claimant-attorney will be surprised when they get a phone call from the General Counsel for the broker/dealer or from the broker individually, offering up the policy. If you are concerned at all about the collectability of your client's claims, you must send a letter requesting coverage information. The advent of RN 18-22 might actually make this easier, since now the policy will likely be produced at some point, and possibly after a too aggressively written statement of claim has already been filed and given the insurer all of the reasons it needed to deny coverage.

Another step is to file simple, bare-bones statements of claim that stay away from statutory violations, allegations of intentional misconduct, and fraud. Then, once the policy is produced, parse it closely and if you can successfully amend your claim to add additional facts and stay within the limitations of coverage, that is a potential route to take. No matter the case, if you are concerned with collectability on the front end, tread carefully.

V. Conclusion

By taking steps to make insurance coverage information "presumptively discoverable" through List 1 of the Discovery Guide, FINRA has taken an important step to assist claimants in determining the existence of insurance coverage. It is not a perfect solution, but it will set FINRA apart from other arbitration forums that have yet to codify the discoverability of liability insurance or indemnity agreements. It is important for the FINRA Lawyer to become educated on insurance coverage issues or risk fumbling an important source of recovery for your client.

EXHIBIT 1

Surplus Lines Declarations

Westchester

[redacted]

Policy No. [redacted]	Renewal of: [redacted]

NAMED INSURED & MAILING ADDRESS

[redacted]

POLICY PERIOD

When Coverage Begins: **06/01/2017** 12:01 A. M. Local Time At Named Insured's Address

When Coverage Ends: **06/01/2018** 12:01 A. M. Local Time At Named Insured's Address

INSURING COMPANY	Producer's Name & Address:
[redacted]	[redacted] Producer No: [redacted]

This contract is registered and delivered as a surplus line coverage under the Surplus Line Insurance Law, O.C.G.A. Chapter 33-5.

Westchester
[redacted]

Securities Broker-Dealer Professional Liability Insurance Policy

This Policy is issued by the insurance company listed above (herein called the Insurer).

THIS POLICY IS A CLAIMS MADE AND REPORTED POLICY. EXCEPT AS OTHERWISE PROVIDED HEREIN, THIS POLICY COVERS ONLY CLAIMS FIRST MADE AGAINST THE INSUREDS AND REPORTED TO THE INSURER DURING THE POLICY PERIOD. PLEASE READ THIS POLICY CAREFULLY.

THIS POLICY CONTAINS TERMS AND CONDITIONS WHICH LIMIT THE AMOUNT OF DEFENSE COSTS FOR WHICH THE INSURER WILL BE REPONSIBLE TO PAY. SUCH PAYMENT FOR DEFENSE COSTS SHALL BE SUBJECT TO A SELF-INSURED RETENTION AS WELL AS AN AGGREGATE LIMIT OF LIABILITY AS LISTED IN ITEM 3. OF THESE DECLARATIONS AND WILL REDUCE THE APPLICABLE LIMIT OF LIABILITY.

DECLARATIONS

Policy N . [redacted]	Renewal of [redacted]
Item 1. Insured Broker-Dealer Principal Address:	[redacted]
Item 2. Policy Period: From 12:01 A.M. 06/01/2017 To 12:01 A.M. 06/01/2018 (Local time at the address shown in Item **1**)	
Item 3. Limits of Liability	
a. Each **Claim** under Insuring Agreement **A.**	$1,000,000
b. Each **Claim** under Insuring Agreement **B.**	$1,000,000
c. Maximum **Policy** Aggregate	$2,000,000
Item 4. Coinsurance Coinsurance Percentage: 0 %	

THIS CONTRACT IS REGISTERED AND
DELIEVERED AS A SURPLUS LINE
COVERAGE UNDER THE SURPLUS LINE
INSURANCE LAW O.C.G.A
CHAPTER 33-5
SURPLUS LINES BROKER:
MICHAEL CAVALLARO

Item 5. **Self-Insured Retention** for each **Loss**:

Applicable to:

a.	An **Insured Broker-Dealer**:	$25,000
b.	An **Insured Registered Representative**:	$5,000
c.	An **Insured Registered Representative** in Connection with the sale of Insurance Products:	$5,000

Item 6. Notice to **Insurer**:

a. Notice of **Claim** or **Wrongful Act**:

Professional Liability Claims
PO Box 5119
Scranton, PA 18505-0549
First Notices Fax:
215.640.5040 or 1.877.746.4671
General Correspondence Fax:
1.866.635.5688
First Notices Email:
aceclaimsfirstnotice@chubb.com

b. All other notices:

Financial Lines Division
Westchester Specialty Group
11575 Great Oaks Way, Suite 200
Alpharetta, GA 30022

Item 7. **Retroactive Date**: 06/01/2010

Item 8. **Policy** Premium: $69,054.00
sl tax $2,762.16

Item 9. Endorsements Effective at Inception:

IL P 001 (01/04) - U.S. Treasury Departments Office Of Foreign Assets Control (OFAC) Advisory Notice To Policyholders
LD-5S23j (03/14) - Signature Endorsement
SLPD (03/08) - Surplus Lines Declarations
-
PF-46422 (07/15) - Trade or Economic Sanctions Endorsement
PF-22482 (06/07) - Late Trading, Market Timing, Directed Brokerage And Front Running Exclusion Endorsement
PF-24619 03/08 BD - Breakpoint Exclusion
PF-25482 (08/08) - DELETE COVERAGE FOR NEW YORK REGISTERED REPRESENTATIVES ENDORSEMENT ALLOCATION PROVISION SPECIFIED PERSON CARVE-OUT
PF-25685 (09/09) - SPECIFIED INDIVIDUALS AND ENTITIES EXCLUSION MADOFF, STANFORD, AGAPE,WESTRIDGE, PETTERS, GEMINI, DISP, PEARLMAN, HEALTH & ASSOCIATES
PF-25535 (12/08) - Auction Rate Securities Exclusion
PF-32786 (02/11) - Tenant In Common Exchange Exclusions
PF-25614 (07/09) - ADDITIONAL INSURED - VICARIOUS LIABILITY ONLY CLAIMS BROUGHT BY - EXCLUDED
PF-28211 (12/09) - Aggregate Limit of Liability Increased Retroactive Date Amended
PF-28186 (11/09) - Additional Insured Registered Investment Advisors
PF-28269 (04/10) - Additional Insured

[redacted]

DATE: 06/29/2017

AUTHORIZED REPRESENTATIVE

[redacted]

Securities Broker-Dealer Professional Liability Insurance Policy

This Policy is issued by the insurance company listed above (herein called the Insurer).

THIS POLICY IS A CLAIMS MADE AND REPORTED POLICY. EXCEPT AS OTHERWISE PROVIDED HEREIN, THIS POLICY COVERS ONLY CLAIMS FIRST MADE AGAINST THE INSUREDS AND REPORTED TO THE INSURER DURING THE POLICY PERIOD. PLEASE READ THIS POLICY CAREFULLY.

THIS POLICY CONTAINS TERMS AND CONDITIONS WHICH LIMIT THE AMOUNT OF DEFENSE COSTS FOR WHICH THE INSURER WILL BE REPONSIBLE TO PAY. SUCH PAYMENT FOR DEFENSE COSTS SHALL BE SUBJECT TO A SELF-INSURED RETENTION AS WELL AS TO THE LIMITS OF LIABILITY LISTED IN ITEM 3. OF THE DECLARATIONS.

Throughout this policy the word Insurer shall refer to the insurance company providing this insurance. Words and phrases that appear in bold-face type have special meanings and are defined in Section **III.** - Definitions of this policy.

In consideration of the payment of premium and in reliance upon all statements made and information furnished by the **Insured Broker-Dealer** to the Insurer in the **Application**, which is hereby deemed attached to and made a part of this **Policy**, and subject to the foregoing Declarations and to all other terms of this **Policy**, the **Insured Broker-Dealer**, the **Insured Registered Representatives** and the Insurer agree as follows:

I. INSURING AGREEMENTS

A. The Insurer shall pay on behalf of the **Insured Broker-Dealer**, **Loss** which the **Insured Broker-Dealer** becomes legally obligated to pay by reason of any **Claim** first made against the **Insured Broker-Dealer** during the **Policy Period**, or any applicable **Extended Reporting Period**, and reported in writing to the Insurer during the **Policy Period** or, if exercised, the **Extended Reporting Period** in accordance with the terms of this **Policy**, for any **Wrongful Acts** taking place after the **Retroactive Date** but before the expiration of the **Policy**:

1. In rendering or failing to render **Professional Services** by **the Insured Broker-Dealer**; or

2. In failing to supervise an **Insured Registered Representative** in the rendering or failing to render **Professional Services** by such **Insured Registered Representative** on the behalf of the **Insured Broker-Dealer**.

B. The Insurer shall pay on behalf of the **Insured Registered Representative**, **Loss** which the **Insured Registered Representative** becomes legally obligated to pay by reason of any **Claim** first made against the **Insured Registered Representative** during the **Policy Period**, or any applicable **Extended Reporting Period**, and reported in writing to the Insurer during the **Policy Period** or, if exercised, the **Extended Reporting Period** in accordance with the terms of this **Policy**, for any **Wrongful Acts** by the **Insured Registered Representative** in rendering or failing to render **Professional Services** on behalf of the **Insured Broker-Dealer**, provided such **Wrongful Acts** take place after the **Retroactive Date** but before the expiration of the **Policy**.

II. DEFENSE, INVESTIGATION AND SETTLEMENT

A. The Insurer shall have the right and duty to defend any **Claim** covered by this **Policy**, even if any of the allegations in the **Claim** are groundless, false or fraudulent. The Insurer's duty to defend, and obligation to settle or pay, shall cease upon exhaustion of the applicable Limit of Liability under this **Policy** as set forth in Item **3.** of the Declarations. **Defense Costs** under this **Policy** shall be part of, and not in addition to, the applicable Limit of Liability.

B. The Insurer shall have the right to make any investigation it deems necessary with respect to any **Claim** under this **Policy** and to assign defense counsel as it deems appropriate. The Insurer shall have the right to make, with the written consent of the **Insured**, any settlement of a **Claim** under this **Policy**. If the **Insured** refuses to consent to any settlement recommended by the Insurer and deemed acceptable to the claimant, the Insurer may then withdraw from the defense of the **Claim** by tendering control of the defense to the **Insured**, and the **Insured** shall thereafter at its own expense negotiate or defend such **Claim** independently of the Insurer, and the Insurer's liability shall not exceed the amount of damages for which the **Claim** could have been settled if such recommendation was consented to, plus **Defense Costs** incurred by the Insurer, and **Defense Costs** incurred by the **Insured** with the Insurer's prior written consent, up to the date of such refusal.

C. The **Insured** agrees not to settle or offer to settle any **Claim**, incur any **Defense Costs** or otherwise assume any obligation or admit any liability with respect to any **Claim** without the Insurer's prior written consent. The Insurer shall not be liable for any settlement, **Defense Costs**, assumed obligation or admission to which it has not consented.

D. The **Insured** agrees to provide the Insurer and defense counsel with all information, assistance and cooperation which the Insurer or defense counsel reasonably requests, and agrees that in the event of a **Claim**, the **Insured** will do nothing that shall prejudice the Insurer's position or its potential or actual rights of recovery. The Insurer may make any investigation it deems necessary.

E. The Insurer and the **Insured** shall not unreasonably withhold any consent referenced in this Section **II.**

III. DEFINITIONS

When used in this **Policy**, the following terms have the following meanings:

A. **Application** means all signed **Applications**, including any attachments thereto, and all other information and materials submitted therewith or incorporated therein by or on behalf of the **Insureds** to the Insurer in connection with the Insurer underwriting this **Policy** or any **Policy** issued by the Insurer of which this **Policy** is a direct or indirect renewal or replacement. **Application** includes any public documents filed by the **Insured Broker-Dealer** with any federal, state, local or foreign regulatory body, including but not limited to the Securities and Exchange Commission. All such **Applications**, attachments, information and materials are deemed attached to and incorporated into this **Policy**.

B. **Approved Activity** means a service or activity performed by the **Insured Registered Representative** on behalf of the **Insured Broker-Dealer** which:

1. Has been approved by the **Insured Broker-Dealer** to be performed by the **Insured Registered Representative**; and

2. Is performed in connection with the purchase or sale of securities which have been approved by the **Insured Broker-Dealer** to be transacted through the **Insured Registered Representative**, or in connection with the purchase and sale of insurance products which have been disclosed to the **Insured Broker-Dealer** by the **Insured Registered Representative** as an outside business activity and which have, as such, been approved by the **Insured Broker-Dealer**; and

3. For which the **Insured Registered Representative** has obtained all licenses required by the **Insured Broker-Dealer** or applicable law or regulation.

C. **Claim** means:

1. A written demand for monetary damages;

2. A civil proceeding commenced by the service of a complaint or similar pleading; and/or

3. An arbitration proceeding.

D. **Cost of Corrections Claim** means any **Claim** based upon, arising out of, or relating to the erroneous execution and/or settlement of a transaction. **Cost of Corrections Claim** also means any **Claim** based upon, arising out of, or relating to the alleged failure to execute a transaction.

E. **Defense Costs** means the reasonable and necessary costs, charges, fees (including but not limited to attorneys' fees and experts' fees) and expenses (other than regular or overtime wages, salaries or fees of the directors, officers or employees of the **Insured**) incurred in defending or investigating **Claims** and the premium for appeal, attachment or similar bonds.

F. **Extended Reporting Period** means the period for the extension of coverage, if exercised, described in Section **VI.** of this **Policy**.

G. **Insured** means, collectively or singly:

1. The **Insured Broker-Dealer** listed in Item **1.** of the Declarations of this **Policy**; and

2. An **Insured Registered Representative**.

H. **Insured Broker-Dealer** means:

1. The **Insured Broker-Dealer** listed in Item **1.** of the Declarations of this **Policy**; and

2. Any past, present or future director, officer, partner or employee of the **Insured Broker-Dealer**.

However, **Insured Broker-Dealer** does not include an **Insured Registered Representative**.

I. **Insured Registered Representative** means:

1. Any natural person who was, on the inception date of this **Policy**, a duly licensed and registered representative or registered principal of the **Insured Broker-Dealer** in good standing with the National Association of Securities Dealers, Inc. and who, for compensation, engages in the business of rendering **Professional Services** on behalf of the **Insured Broker-Dealer**;

2. Any natural person who was, prior to the inception date of this **Policy** but on or after the **Retroactive Date** set forth in Item **7.** of the Declarations, a duly licensed registered representative or registered principal of the **Insured Broker-Dealer** in good standing with the National Association of Securities Dealers, Inc. and who, for compensation, engaged in the business of rendering **Professional Services** on behalf of the **Insured Broker-Dealer,** but only in connection with a **Claim** based on or arising out of a **Wrongful Act** occurring after the **Retroactive Date**; or

3. Any natural person who became after the inception date of this **Policy** a duly licensed registered representative or registered principal of the **Insured Broker-Dealer** in good standing with the National Association of Securities Dealers, Inc. and who, for compensation, engages in the business of rendering **Professional Services** on behalf of the **Insured Broker-Dealer**, subject to the terms, provisions and conditions of Section **VII.** of this **Policy**.

J. **Interrelated Wrongful Acts** means all **Wrongful Acts** that have as a common nexus any fact, circumstance, situation, event, transaction, cause or series of related facts, circumstances, situations, events, transactions or causes.

K. **Loss** means the damages, judgments, any award of pre-judgment and post-judgment interest, settlements and **Defense Costs** which the **Insured** become legally obligated to pay on account of any **Claim** first made against any **Insured** during the **Policy Period** or, if exercised, the **Extended Reporting Period**, for **Wrongful Acts** for which coverage applies. **Loss** does not include:

1. Any amount for which the **Insureds** are absolved from payment;

2. Taxes, fines or penalties; and/or

3. Punitive, multiplied or exemplary damages.

L. **Policy** means, collectively, the Declarations, the **Application**, this **Policy** form and any endorsements attached hereto.

M. **Policy Period** means the period of time specified in Item **2.** of the Declarations of this **Policy**, subject to prior termination in accordance with Section **XIII.** of this **Policy**.

N. **Pollutants** means any substance located anywhere in the world exhibiting any hazardous characteristics as defined by, or identified on a list of hazardous substances issued by the United States Environmental Protection Agency or any federal, state, county, municipality or locality counterpart thereof or any foreign equivalent. Such substances shall include, without limitation, solids, liquids, gaseous or thermal irritants, contaminants or smoke, vapor, soot, fumes, acids, alkalis, chemicals or waste materials. **Pollutants** shall also mean any other air emission, odor, waste water, oil or oil products, infectious or medical waste, asbestos or asbestos products, noise, fungus (including mold or mildew and any mycotoxins, spores, scents or byproducts produced or released by fungi, but does not include any fungi intended by the **Insured** for consumption) and electric or magnetic or electromagnetic field.

O. **Professional Services**:

1. Means the following services if rendered in connection with an **Approved Activity** for or on behalf of a customer or client of the **Insured Broker-Dealer** pursuant to a written agreement between the **Insured Broker-Dealer** and the customer or client:

a. The purchase or sale of securities, annuities or variable annuities and/or life or accident and health insurance; and

b. Providing brokerage services for individual retirement accounts (IRAs), Keogh retirement plans and employee benefit plans (other than multiple employer or multi-employee welfare arrangements).

2. **Professional Services** does not include:

a. Services performed as a **Registered Investment Advisor** unless such coverage is specifically added to this **Policy** by endorsement; or

b. Providing advice relating to personal risk management or taxes; or the preparation of financial plans, personal financial statements or tax returns.

P. **Registered Investment Advisor** means a natural person or entity registered as an Investment Advisor with the Securities and Exchange Commission and/or the relevant State securities regulatory departments, as the case may be, who provides investment advice and/or management services to customers for a fixed fee, an hourly fee or a fee based on a percentage of customers' assets being managed.

Q. **Retroactive Date** means the date stated in Item **7.** of the Declarations.

R. **Wrongful Act** means any actual or alleged negligent act, error or omission by the **Insured Broker-Dealer** and/or the **Insured Registered Representatives** in connection with the rendering of **Professional Services**.

IV. EXCLUSIONS

The Insurer shall not be liable for **Loss** on account of any **Claim** made against any **Insured**:

A. Based upon, arising out of, or attributable to:

1. Any fact, circumstance or situation which has been the subject of any notice given under any **Policy** of insurance issued by any insurance company to the **Insured Broker-Dealer** or the **Insured Registered Representatives**; or

2. Any other **Wrongful Act** whenever occurring which, together with a **Wrongful Act** which has been the subject of such notice, would constitute **Interrelated Wrongful Acts**.

B. Based upon, arising out of, or attributable to any **Wrongful Act** or **Interrelated Wrongful Act** first occurring before the applicable **Retroactive Date** set forth in Item **7.** of the Declarations of this **Policy**, even when the **Wrongful Act** or **Interrelated Wrongful Act** continued after the **Retroactive Date** set forth in Item **7.** of the Declarations.

C. Based upon, arising out of, or attributable to any bodily injury, emotional distress, mental anguish, discrimination, sexual harassment, sickness, disease or death of any person, or for damage to or destruction of any tangible property including loss of use thereof or for libel or slander or defamation or disparagement, or for injury from a violation of a person's right of privacy.

D. Based upon, arising out of, or attributable to:

1. The actual, alleged or threatened discharge, dispersal, release, escape, seepage, migration or disposal of **Pollutants** into or on real or personal property, water or the atmosphere; or

2. Any direction or request that the **Insureds** test for, monitor, clean up, remove, contain, treat, detoxify or neutralize **Pollutants**, or any voluntary decision to do so; including without limitation any actual or alleged property damage or financial **Loss** incurred by, or bodily injury, sickness, disease or death of, any **Insured** or any client or other person or organization resulting from the matters described in this Exclusion **D.**

E. For **Wrongful Acts** actually or allegedly committed or attempted by a subsidiary, affiliate or parent company of the **Insured Broker-Dealer** unless such subsidiary, affiliate or parent company is specifically named in the Declarations and coverage is provided by endorsement to this **Policy**.

F. For **Wrongful Acts** committed or attempted by a subsidiary, affiliate or parent company of the **Insured Broker-Dealer** before the date such subsidiary, affiliate or parent company became an **Insured** under this **Policy**.

G. Based upon, arising out of, or attributable to any **Wrongful Act** committed by an **Insured** with actual knowledge of its wrongful nature or with intent to cause damage.

H. Based upon, arising out of, or attributable to any criminal or deliberately fraudulent act, or any willful violation of any law of the United States or Canada, or state, province, territory, county, political division or municipality thereof, or any rules or regulations promulgated thereunder.

I. Based upon, arising out of, or attributable to an **Insured** gaining any profit, remuneration or financial advantage to which such **Insured** was not legally entitled, including any actual or alleged commingling of funds or accounts.

J. Brought by or on behalf of any **Insured**, the successors or assigns of any **Insured**, or trustee in bankruptcy; or by or on behalf of any enterprise, trust or other entity that is operated or managed or owned, directly or indirectly, in whole or in part, by any **Insured**; or for which any **Insured** is a trustee, fiduciary, director or officer thereof.

K. For the actual or alleged breach of any oral, written or implied contract or agreement, but this exclusion shall not apply if and to the extent that liability would have attached to the **Insureds** in the absence of such contract or agreement.

L. If such **Loss** constitutes:

1. The cost of any remedial, preventive or other non-monetary relief including without limitation any costs associated with compliance with any such relief of any kind or nature imposed by any judgment, settlement, or governmental authority; or

2. Compensation paid to or claimed by an **Insured** for **Professional Services**, unless such compensation is used as a measure of damages incurred by the claimant.

M. Based upon, arising out of, or attributable to the rendering or failure to render **Professional Services** by the **Insured** as an actuary, accountant, including tax preparation, attorney, real estate agent, real estate broker, property and/or casualty insurance agent, third party claims administrator, trustee, fiduciary, escrow agent, notary public or mortgage banker or broker.

N. Brought by or on behalf of any clearing agency or brokerage firm, or based upon, arising out of, or attributable to any function of an **Insured** as a clearing agent or brokerage firm.

O. Based upon, arising out of, or attributable to a dispute over fees, commissions, charges, or other compensation, including without limitation the structure or reasonableness of any compensation, client lists, other client information or entitlements.

P. Based upon, arising out of, or attributable to any activities related to the exercise of discretionary authority with regard to the management or disposition of assets, whether for individuals, groups, employee benefit plans, or other entities of any legal form or character.

Q. Based upon, arising out of, or attributable to the insolvency, receivership, bankruptcy, conservatorship, liquidation or inability or refusal to pay of any broker or dealer in securities or commodities, clearing agency, bank or banking firm, or any insurance or reinsurance entity or any **Insured**; provided, however, this exclusion does not apply to **Wrongful Acts** solely in connection with any **Insured's** investment on behalf of the claimant in any stock of any foregoing entity.

R. Based upon, arising out of, or attributable to the **Insured's** activities relating to computer programming or processing if the resulting programs are sold or distributed or if a fee is charged for use of the programs.

S. Brought or maintained in any capacity by or on behalf of any governmental or quasi-governmental official, agency or self-regulatory organization, including without limitation the Securities and Exchange Commission, the National Association of Securities Dealers (NASD), the Securities Investor Protection Corporation, or any state or federal securities or insurance commission, agency or official, but this exclusion shall not apply to any **Claim** by such official, agency or organization in its capacity as a direct client of an **Insured**.

T. Based upon, arising out of, or attributable to investment products partially or totally owned or controlled by any **Insured**, or to securities for which the **Insured** acts as a market maker.

U. Based upon, arising out of, or attributable to the management, operation, condition or activities of any pension, profit sharing, health and welfare or other employee benefit plan or trust sponsored by the **Insured** or any entity owned or controlled by the **Insured** or in which the **Insured** is a participant, trustee or named fiduciary, as defined under Employee Retirement Income Security Act of 1974 as amended.

V. Based upon, arising out of, or attributable to the sale, attempted sale, or servicing of:

1. Commodities, commodity future contracts, any type of option contract or derivative;

2. Any collectible, including, but not limited to, stamps, art, sports or other cards, jewelry, coins, antiques or any other tangible personal property;

3. Any equity securities priced under $5.00 at the time of the alleged **Wrongful Act** giving rise to such **Claim**, but this exclusion shall not apply if such securities are listed on the New York Stock Exchange or NASDAQ or American Stock Exchange;

4. Any security in any market outside the United States of America and its territories and possessions and Canada;

5. Annuities used in connection with any structured settlement;

6. Corporate Owned Life Insurance (COLI) or any other types of policies where the purchaser of the life product does not have a direct interest in the beneficiary under the life policy;

7. Limited Partnerships, Real Estate Investment Trusts ("REITs"), promissory notes, issuer callable certificates of deposit and/or equipment sale-lease-buy-back transactions of any kind;

8. Viatical settlements, reverse mortgages or similar transactions in which the present value of a conditional contract is exchanged or sold; and/or

9. Transactions involving the use of, or investment in, hedge funds of any kind.

W. For **Wrongful Acts** in connection with an **Insured** giving advice, or performing services with respect to, any aspect of investment banking, including but not limited to, underwriting, syndicating or promoting any security or partnership interest in connection with any actual, alleged or threatened merger, acquisition, divestiture, tender offer, proxy contest, leveraged buy-out, public offering, going private transaction, reorganization, restructuring,

recapitalization, spin-off, primary or secondary offering of securities whether public or private, dissolution or sale of all or substantially all of the assets or stock of a business entity, or effort to raise or furnish capital or financing for any enterprise or entity, or any acquisition or sale of securities by the **Insured Broker-Dealer** for its own account, or any activity by an **Insured** as a specialist or market maker for any securities, or any disclosure requirements in connection with any of the foregoing, including, but not limited to the rendering of advice or recommendations, or the rendering of a written opinion in connection with any of the foregoing.

X. Based upon, arising out of or attributable to use by an **Insured** of, or an **Insured's** disclosure to another person of, or actual or alleged participating after the fact by an **Insured** in the use of, non-public information in a manner prohibited by the laws of the United States, including without limitation Section 10(b) or 20(A) of the Securities Exchange Act of 1934 (as amended) and Rule 10b-5 thereunder, or the laws of any state, commonwealth, territory or subdivision thereof, or the laws of any other jurisdiction, or any rules or regulations promulgated under any of the foregoing.

Y. Based upon, arising out of, or attributable to the rendering or failure to render **Professional Services** to any securities broker-dealer other than a dealer which buys, sells, or trades in securities exclusively as a principal for its own account.

Z. Based upon, arising out of, or attributable to any activities of, or services provided by an **Insured Registered Representative** which is not a **Professional Service** rendered on behalf of the **Insured Broker-Dealer**, including, but not limited to, **Claims** against the **Insured Broker-Dealer** and/or the **Insured Registered Representatives** arising out of or in any way relating to the "outside business activities" of, or "selling away" (as generally defined in (NASD) Notices to Members No. 01-79) by an **Insured Registered Representative**.

AA. Alleging, arising out of, based upon or attributable to any mechanical or electronic failure, breakdown or malfunction of machines or systems including hardware and software.

BB. Alleging, arising out of, based upon or attributable to the **Insured Broker-Dealer** acting as a successor in interest to another entity including but not limited to another securities broker-dealer.

CC. Alleging, arising out of, based upon or attributable to any dispute between **Insureds**.

DD. Alleging, arising out of, based upon or attributable to the **Insured** failing to disclose its status as a market maker in connection with any research or recommendations provided to a customer or client of the **Insured Broker-Dealer**.

EE. Alleging, arising out of, based upon or attributable to any **Cost of Corrections Claim**.

FF. Alleging, arising out of, based upon or attributable to the **Insured** failing to disclose to a customer or client of the **Insured Broker-Dealer** that it has an investment banking relationship with a company, the securities of which have been recommended to such customer or client for either purchase or sale.

GG. Alleging, arising out of, based upon or attributable to any **Wrongful Act** occurring prior to the inception date of the first Securities Broker-Dealer Professional Liability Insurance Policy issued to the **Insured Broker-Dealer** by the Insurer and continuously renewed and maintained in effect thereafter to the inception date of this **Policy**, if on or before such date any **Insured** knew or could have reasonably foreseen that such **Wrongful Act** could lead to a **Claim**, or alleging, arising out of, based upon or attributable to any subsequent **Interrelated Wrongful Act**.

V. SEVERABILITY OF EXCLUSIONS

For the purpose of determining the applicability of any exclusion set forth in Section **IV.** EXCLUSIONS:

A. The **Wrongful Act** of any **Insured** shall not be imputed to other natural person **Insureds**; and

B. Only the **Wrongful Act** of any officer of the **Insured Broker-Dealer** shall be imputed to the **Insured Broker-Dealer**.

VI. EXTENDED REPORTING PERIOD

A. If the Insurer terminates or does not renew this **Policy** (other than for failure to pay a premium when due), the **Insured Broker-Dealer** may request in writing to the Insurer an extension of the coverage granted by this **Policy** for thirty (30) days following the effective date of such termination or nonrenewal, but only with respect to a covered **Wrongful Act** taking place during the **Policy Period** and prior to the effective date of such nonrenewal or termination and for payment of the additional premium described below. The option to extend shall lapse unless written notice of such election, is given by the **Insured Broker-Dealer** to the Insurer within five (5) days following the expiration of the **Policy Period** or the effective date of termination or nonrenewal.

B. The premium due for such **Extended Reporting Period** shall be determined by the Insurer at the time the **Insured Broker-Dealer** requests such extension. The **Insured Broker-Dealer** shall provide to the Insurer any information as the Insurer may reasonably request. Upon receipt of such information the Insurer may, at its sole discretion, advise the **Insured Broker-Dealer** of the additional premium required to be paid to purchase the **Extended Reporting Period**. Payment of such additional premium must be given by the **Insured Broker-Dealer** to the Insurer within ten (10) days of the Insurer's quotation to effect coverage. The entire premium for such **Extended Reporting Period** shall be deemed fully earned and non-refundable upon payment.

C. The **Extended Reporting Period**, if provided, shall be part of and not in addition to the Limits of Liability for the **Policy Period**. The purchase of the **Extended Reporting Period** shall not increase or reinstate the applicable Limits of Liability, which shall be the maximum liability of the Insurer for such **Policy Period** and **Extended Reporting Period**, combined.

D. In the event that the **Insured Broker-Dealer** fails to remit payment of the requested additional premium within ten (10) days of the Insurer's quotation, any coverage that would otherwise have been afforded to the **Insureds** under the **Extended Reporting Period** shall be deemed void from inception, with no additional coverage being deemed to have been afforded.

VII. REGISTERED REPRESENTATIVES

A. The **Insured** acknowledges that:

1. The premium charged by the Insurer for this **Policy** is based, in part, upon the number of registered representatives registered and/or associated with the **Insured Broker-Dealer** at the time the **Application** for coverage was submitted to the Insurer, and at the time of each renewal, if any;

2. The Premium set forth in Item **8.** of the Declarations is a minimum premium that is not refundable in the event that the number of registered representatives decreases during the term of this **Policy** or any renewals hereof; and

3. The Insurer is entitled to charge, and the **Insured Broker-Dealer** is obligated to pay, an additional premium to the Insurer in the event that the number of registered representatives registered and/or associated with the **Insured Broker-Dealer** increases during the **Policy Period** by more than 20% from the number at this **Policy's** inception date.

B. The **Insured Broker-Dealer** agrees to provide the Insurer with any documentation and information that the Insurer may reasonably request during the **Policy Period** in order that the Insurer may determine the number of registered representatives then registered and/or associated with the **Insured Broker-Dealer**.

C. In the event that the **Insured Broker-Dealer** refuses or fails to comply with the Insurers reasonable request for documentation and information within thirty (30) days of the Insurer's written request, the **Insureds** acknowledge that the Insurer may terminate this **Policy** upon thirty (30) days written notice and that the full Premium for this **Policy** shall be retained by the Insurer and be deemed non-refundable.

D. If the number of registered representatives registered and/or associated with the **Insured Broker-Dealer** increases from the time of **Application**, or this **Policy's** inception date by more than 20%, the Insurer shall charge and the **Insured Broker-Dealer** shall pay within thirty (30) days of the Insurer's written request an additional premium equivalent to the original premium divided by the original number of registered representatives set forth in the **Application**, multiplied by the total number of additional registered representatives at the time of the request by the Insurer.

E. The Insurer's failure to request the aforesaid documentation and information from the **Insured Broker-Dealer** during the **Policy Period** shall, in no event, be deemed a waiver of its right to charge an additional premium as aforesaid. The **Insured's** failure to promptly notify the Insurer of a 20% or more increase in its number of registered representatives shall result in coverage being withheld from all registered representatives who first become associated with the **Insured Broker-Dealer** after the inception date of this policy.

VIII. LIMIT OF LIABILITY, RETENTION AND COINSURANCE

A. For the purposes of this **Policy**, all **Claims** arising out of the same **Wrongful Act** and all **Interrelated Wrongful Acts** of the **Insureds** shall be deemed to be one **Claim**, and such **Claim** shall be deemed to be first made on the date the earliest of such **Claims** is first made against the **Insureds**, regardless of whether such date is before or during the **Policy Period**. All **Loss** resulting from a single **Claim** shall be deemed a single **Loss**.

B. The maximum aggregate liability of the Insurer under this **Policy** for all covered **Loss** resulting from all **Claims** under Insuring Agreements **I.A.** and **I.B.** first made during the **Policy Period** shall be the Limits of Liability for this **Policy** as set forth in Item **3.c.** of the Declarations, regardless of the time of payment by the Insurer.

C. Subject to **B.** above and **E.** below, the maximum liability of the Insurer for each **Claim** under Insuring Agreement **I.A.**, whether arising from a single **Wrongful Act** or an **Interrelated Wrongful Act** under the **Policy** shall be the Limit of Liability as set forth in Item **3.a.** of the Declarations.

D. Subject to **B.** above and **E.** below, the maximum liability of the Insurer for each **Claim** under Insuring Agreement **I.B.**, whether arising from a single **Wrongful Act** or an **Interrelated Wrongful Act** under the **Policy** shall be the Limit of Liability as set forth in Item **3.b.** of the Declarations.

E. In the event any **Claim** is covered, in whole or in part, under Insuring Agreement **I.A.** and Insuring Agreement **I.B.**, then the maximum liability of the Insurer for such **Claim**, whether arising from a single **Wrongful Act** or an **Interrelated Wrongful Act** under the **Policy** shall be the greater of the two Limits of Liability as set forth in Items **3.a.** and **3.b.** of the Declarations.

F. **Defense Costs** shall be part of and not in addition to the applicable Limits of Liability set forth in the Declarations, and **Defense Costs** shall reduce the Limits of Liability. If the Limit of Liability with respect to the entire **Policy** is exhausted by payment of **Loss** and/or **Defense Costs**, the Insurer's obligations under the entire **Policy**, respectively, shall be completely fulfilled and extinguished.

G. The Insurer shall only be liable for the amount of **Loss** and **Defense Costs** arising from a **Claim** which is in excess of the applicable **Self-Insured Retention** stated in Item **5.** of the Declarations. Such **Self-Insured Retention** shall be borne by the **Insureds** and shall remain uninsured, with regard to all **Loss** and **Defense Costs** arising from any **Claim**. If a **Claim** is asserted against both the **Insured Broker-Dealer** and an **Insured Registered Representative**, then the applicable **Self-Insured Retention** shall be the greater of the amounts stated in Item **5.** of the Declarations.

H. The Insurer's liability for the amount of **Loss** and **Defense Costs** arising from a **Claim** also shall be subject to the **Insured** paying a portion of such amount in excess of the **Self-Insured Retention** in the form of Coinsurance in the percentages set forth in Item **4.** of the Declarations. The Limits of Liability afforded under this **Policy** shall not be reduced by payments made by the **Insured** in satisfaction of its **Self-Insured Retention** or as Coinsurance.

IX. NOTICE

A. The **Insured** shall, as a condition precedent to their rights under the **Policy**, give to the Insurer written notice of any **Claim** made against the **Insured** as soon as practicable during the **Policy Period**, or if exercised, during the **Extended Reporting Period**, but in no event later than thirty (30) days after the **Insured** knew or should

have known, using reasonable diligence, of the existence of the **Claim**.

B. If during the **Policy Period** or the **Extended Reporting Period**, if exercised, the **Insured** first becomes aware of a specific **Wrongful Act** which may reasonably give rise to a future **Claim** covered under the **Policy** and during such **Policy Period** or **Extended Reporting Period** gives written notice to the Insurer of:

1. The names of the potential claimants and a description of the specific **Wrongful Act** which forms the basis of their potential claim;

2. The identity of the specific **Insureds** allegedly responsible for such specific **Wrongful Act**;

3. The consequences which have resulted or may result from such specific **Wrongful Act**;

4. The nature of the potential monetary damages or non-monetary relief which may be sought in consequence of such specific **Wrongful Act**; and

5. The circumstances by which the **Insureds** first became aware of such specific **Wrongful Act**,

then any **Claim** which arises out of such **Wrongful Act** shall be deemed to have been first made during the **Policy Period** or **Extended Reporting Period**, if exercised, in which such written notice was received by the Insurer. No coverage is provided for **Loss** or **Defense Costs** incurred prior to the time such notice results in a **Claim**.

C. All notices under any provision of this **Policy** shall be in writing and given by prepaid express courier, certified mail or fax properly addressed to the appropriate party. Notice to the **Insured** may be given to the **Insured Broker-Dealer** at the address shown in Item **1.** of the Declarations. Notice to the Insurer of any **Claim**, **Wrongful Act** or **Loss** shall be given to the Insurer at the address in Item **6.a.** of the Declarations. All other notices to the Insurer under this **Policy** shall be given to the Insurer at the address in Item **6.b.** of the Declarations. Notice given as described above shall be deemed to be received and effective upon actual receipt thereof by the addressee or one day following the date such notice is sent, whichever is earlier.

X. OTHER INSURANCE

If any **Loss** under this **Policy** is **Insured** under any other valid insurance policy(ies), then this **Policy** shall cover such **Loss**, subject to its limitations, conditions, provisions and other terms, only to the extent that the amount of such **Loss** is in excess of the amount of such other insurance whether such other insurance is stated to be primary, contributory, excess, contingent or otherwise, unless such other insurance is specifically written as excess insurance over the Limits of Liability provided under this **Policy**.

XI. MATERIAL CHANGES IN CONDITIONS

A. Acquisition of **Insured Broker-Dealer**

If, during the **Policy Period**, any of the following events occurs:

1. The acquisition of the **Insured Broker-Dealer**, or of all or substantially all of its assets, by another entity, or the merger or consolidation of the **Insured Broker-Dealer** into or with another entity such that the **Insured Broker-Dealer** is not the surviving entity; or

2. The obtaining by any person, entity or affiliated group of persons or entities of the right to elect, appoint or designate at least fifty percent (50%) of the directors of the **Insured Broker-Dealer**;

then coverage under this **Policy** will continue in full force and effect until termination of this **Policy**, but only with respect to **Claims** for covered **Wrongful Acts** taking place or covered **Loss** sustained before such event. Coverage under this **Policy** will cease as of the effective date of such event with respect to **Claims** for **Wrongful Acts** taking place and **Loss** sustained after such event.

If such event occurs, the **Insured** may request from the Insurer an **Extended Reporting Period** pursuant to Section **VI.** of this **Policy**.

B. Cessation of Subsidiaries

If before or during the **Policy Period** an organization ceases to be a subsidiary, any coverage afforded under this **Policy** with respect to such subsidiary shall continue until termination of this **Policy**. Such coverage

continuation shall apply only with respect to **Claims** for covered **Wrongful Acts** taking place prior to the date such organization ceased to be a subsidiary.

XII. REPRESENTATIONS

A. The **Insured Broker-Dealer** represents and acknowledges that the statements contained in the **Application** and any materials submitted or required to be submitted or any other information gathered in the underwriting process therewith (all of which shall be maintained on file by the Insurer and be deemed attached to and incorporated into this **Policy** as if physically attached), are true and:

1. Are the basis of this **Policy** and are to be considered as incorporated into and constituting a part of this **Policy**; and

2. Shall be deemed material to the acceptance of this risk or the hazard assumed by the Insurer under this **Policy**. This **Policy** is issued in reliance upon the truth of such representations.

B. In the event the **Application**, including materials submitted or required to be submitted therewith, contains any misrepresentation or omission:

1. Made with the intent to deceive; or

2. Which materially affects either the acceptance of the risk or the hazard assumed by the Insurer under this **Policy**;

this **Policy** shall be void *ab initio* ("from the beginning").

XIII. TERMINATION OF POLICY

A. This **Policy** shall terminate at the earliest of the following times:

1. The effective date of termination specified in a prior written notice by the **Insured Broker-Dealer** to the Insurer;

2. Thirty (30) days after receipt by the **Insured Broker-Dealer** of a written notice of termination from the Insurer;

3. Ten (10) days after receipt by the **Insured Broker-Dealer** of a written notice of termination from the Insurer for failure to pay a premium when due, unless the premium is paid within such ten (10) days period;

4. Upon expiration of the **Policy Period** as set forth in Item **2.** of the Declarations; or

5. At such other time as may be agreed upon by the Insurer and the **Insured Broker-Dealer**.

B. Except for any additional premium applicable to an **Extended Reporting Period**, as set forth in Section **VI.** of this **Policy**, if the **Policy** is terminated by the **Insured Broker-Dealer**, the Insurer shall refund the unearned premium computed at the customary short rate. If the **Policy** is terminated by the Insurer, the Insurer shall refund the unearned premium computed pro rata. Payment or tender of any unearned premium by the Insurer shall not be a condition precedent to the effectiveness of such termination, but such payment shall be made as soon as practicable.

XIV. TERRITORY

This **Policy** only applies to **Claims** which are brought in the United States of America, its territories or possessions or Canada, alleging **Wrongful Acts** committed in the United States of America, its territories or possessions or Canada.

XV. SUBROGATION

In the event of any payment under this **Policy**, the Insurer shall be subrogated to the extent of such payment to all the **Insureds**' rights of recovery. The **Insureds** shall execute all papers required and shall do everything necessary to secure and preserve such rights, including the execution of such documents necessary to enable the Insurer effectively to bring suit or otherwise pursue subrogation rights in the name of the **Insureds**.

XVI. ACTION AGAINST THE INSURER

Except as provided in Section **XX,** no action shall lie against the Insurer. No person or organization shall have any

right under this **Policy** to join the Insurer as a party to any action against any **Insured** to determine the liability of the **Insured** nor shall the Insurer be impleaded by any **Insured** or its legal representatives. Bankruptcy or insolvency of any **Insured** or of the estate of any **Insured** shall not relieve the Insurer of its obligations nor deprive the Insurer of its rights or defenses under this **Policy**.

XVII. AUTHORIZATION CLAUSE

By acceptance of this **Policy**, the **Insured Broker-Dealer** agrees to act on behalf of the **Insureds** with respect to the giving and receiving of notice of **Claim** or termination, the payment of premiums and additional premium and the receiving of any return premiums that may become due under this **Policy**, the agreement to and acceptance of endorsements, and the giving or receiving of any notice provided for in this **Policy**, and the **Insureds** agree that the **Insured Broker-Dealer** shall act on their behalf.

Notice to any agent or knowledge possessed by any agent or any other person shall not effect a waiver or a change in any part of this **Policy** or estop the Insurer from asserting any right under the terms of this **Policy**.

XVIII. ESTATES, LEGAL REPRESENTATIVES AND SPOUSES

The estates, heirs, legal representatives, assigns and spouses of **Insured Registered Representatives** shall be considered **Insureds** under this **Policy**, but coverage is afforded to such estates, heirs, legal representatives, assigns and spouses only for **Claims** arising solely out of their status as such and, in the case of a spouse, where such **Claim** seeks damages from marital community property, jointly held property or property transferred from the **Insured Registered Representative** to the spouse. No coverage is provided for any **Wrongful Act** of an estate, heir, legal representative, assign or spouse. All terms and conditions of this **Policy**, including without limitation the **Self-Insured Retention**, Coinsurance and Limits of Liability shall also apply to **Loss** incurred by such estates, heirs, legal representatives, assigns and spouses.

XIX. ALTERATION, ASSIGNMENT AND HEADINGS

No change in, modification of, or assignment of interest under this **Policy** shall be effective except when made by a written endorsement to this **Policy** which is signed by an authorized representative of the Insurer.

The titles and headings to the various parts, sections, subsections and endorsements of the **Policy** are included solely for ease of reference and do not in any way limit, expand or otherwise affect the provisions of such parts, sections, subsections or endorsements.

XX. ARBITRATION

The **Insured** and the Insurer shall submit any dispute, controversy or **Claim** arising out of or relating to this **Policy** or the breach, termination or invalidity thereof to final and binding arbitration pursuant to such rules and procedures as the parties may agree. If the parties cannot so agree, the arbitration shall be administered by the American Arbitration Association in accordance with its then prevailing commercial arbitration rules. The arbitration panel shall consist of one arbitrator selected by the **Insureds**, one arbitrator selected by the Insurer, and a third independent arbitrator selected by the first two arbitrators. In any such arbitration, each party will bear its own legal fees and expenses. The arbitration shall take place in New York, New York and New York law shall apply without application of conflicts of laws principals.

SIGNATURES

Named Insured [redacted]			Endorsement Number
Policy Symbol **DON**	Policy Number [redacted]	Policy Period **06/01/2017 to 06/01/2018**	Effective Date of Endorsement **06/01/2017**
Issued By (Name of Insurance Company) [redacted]			

THE ONLY SIGNATURES APPLICABLE TO THIS POLICY ARE THOSE REPRESENTING THE COMPANY NAMED ON THE FIRST PAGE OF THE DECLARATIONS.

By signing and delivering the policy to you, we state that it is a valid contract.

[redacted] (A stock company)

WESTCHESTER SURPLUS LINES INSURANCE COMPANY (A stock company)
Royal Centre Two, 11575 Great Oaks Way, Suite 200, Alpharetta, GA 30022

[redacted]

[redacted]

Authorized Representat ve

[redacted]

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

Named Insured [redacted]			Endorsement Number
Policy Symbol **DON**	Policy Number [redacted]	Policy Period **06/01/2017 to 06/01/2018**	Effective Date of Endorsement **06/01/2017**
Issued By (Name of Insurance Company) [redacted]			

AMENDED PREMIUM – DISCOVERY PERIOD

It is agreed that Section VI, **Extended Reporting Period**, is amended by deleting subsection B in its entirety and replacing it with the following:

B. The premium due for the **Extended Reporting Period**, if elected by the **Named Insured**, shall be 1-year @ 175 % of the **Policy** premium. Payment of such additional premium must be given by the **Insured Broker-Dealer** to the Insurer within ten (10) days of the Insurer's quotation to effect coverage. The entire premium for such **Extended Reporting Period** shall be deemed fully earned and non-refundable upon payment.

All other terms and conditions of this **Policy** remain unchanged.

Authorized Representative

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ADDITIONAL INSURED

Named Insured [redacted]			Endorsement Number
Policy Symbol **DON**	Policy Number [redacted]	Policy Period **06/01/2017 to 06/01/2018**	Effective Date of Endorsement **06/01/2017**
Issued By (Name of Insurance Company) [redacted]			

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

THIS ENDORSEMENT MODIFIES INSURANCE PROVIDED UNDER THE FOLLOWING:

SECURITIES BROKER-DEALER PROFESSIONAL LIABILITY INSURANCE POLICY

It is agreed that the **Policy** is amended as follows:

1. Section I, Insuring Agreements, is amended by adding the following at the end thereof:

   C. The Insurer shall pay on behalf of the **Additional Insured**, **Loss** which the **Additional Insured** becomes legally obligated to pay by reason of any **Claim** first made against the **Additional Insured** during the **Policy Period**, or any applicable **Extended Reporting Period**, and reported in writing to the Insurer during the **Policy Period** or, if exercised, the **Extended Reporting Period** in accordance with the terms of this **Policy**, for any **Wrongful Acts** by the **Additional Insured** in rendering or failing to render **Professional Services** on behalf of the **Insured Broker-Dealer**, provided such **Wrongful Acts** take place after the **Retroactive Date** but before the expiration of the **Policy**.

2. Section III, Definitions, subsection G, **Insured**, is amended to include the following:

   - Triumph Insurance Advisor, Inc.

     (referred to herein as "**Additional Insured(s)**")

3. Section III, Definitions, subsection B, **Approved Activity** and subsection R, **Wrongful Act**, are deleted in their entirety and replaced with the following:

   B. **Approved Activity** means a service or activity performed by the **Insured Registered Representative** or **Additional Insured** on behalf of the **Insured Broker-Dealer** which:

   1. Has been approved by the **Insured Broker-Dealer** to be performed by the **Insured Registered Representative** or **Additional Insured**; and
   2. Is performed in connection with the purchase or sale of securities which have been approved by the **Insured Broker-Dealer** to be transacted through the **Insured Registered Representative** or **Additional Insured**, or in connection with the purchase and sale of insurance products which have been disclosed to the **Insured Broker-Dealer** by the **Insured Registered Representative** or **Additional Insured** as an outside business activity and which have, as such, been approved by the **Insured Broker-Dealer**; and
   3. For which the **Insured Registered Representative** or **Additional Insured** has obtained all licenses required by the **Insured Broker-Dealer** or applicable law or regulation.

   R. Wrongful Act means any actual or alleged negligent act, error or omission by the **Insured Broker-Dealer** and/or the **Insured Registered Representatives** and/or the **Additional Insured** in connection with the rendering of **Professional Services**.

4. Section IV, Exclusions, subsections A, E, F, W, BB, DD and FF are amended by adding "or **Additional Insured**" immediately after "**Insured Broker-Dealer**."

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THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

Named Insured [redacted]			Endorsement Number
Policy Symbol **DON**	Policy Number [redacted]	Policy Period **06/01/2017 to 06/01/2018**	Effective Date of Endorsement **06/01/2017**
Issued By (Name of Insurance Company) [redacted]			

LATE TRADING, MARKET TIMING, DIRECTED BROKERAGE AND FRONT RUNNING EXCLUSION ENDORSEMENT

It is agreed that:

1. Section IV, Exclusions, is amended by adding the following to subsection A:

   - Based upon, arising out of, attributable to, or alleging that any **Insured** permitted, aided or abetted others in using, was aware of others using, was a participant in using, or was connected in any way to the use of Late Trading, Market Timing, Directed Brokerage or Front Running relating to a Mutual Fund.

2. Section III, Definitions, is amended by adding the following:

   Front Running means the trading by anyone associated with a Mutual Fund of any securities based on information received internally, before third parties have been given the information.

   Late Trading means:

   (1) any transaction involving Mutual Fund shares that are made after the termination of the Mutual Fund's Current Net Asset Value (as defined in Rule 2a-4 of the Investment Company Act of 1940), including but not limited to the placement or confirmation of orders for, or the purchase or redemption of, Mutual Fund shares, but made at a price based on the Mutual Fund's previously determined Current Net Asset Value calculated that same day, in contravention of Rule 22c-1 of the Investment Company Act of 1940;

   (2) violations of laws, rules or regulations relating to the rule of forward pricing;

   (3) allegations that, after the close of trading, hedge funds or other investors were allowed to cancel orders of the Mutual Fund shares or securities that were made prior to the close of trading; or

   (4) any transaction defined as late trading by any state, federal, local or foreign statute or regulation, or any prospectus, policy, limitation, agreement or procedure of the Mutual Fund.

   Market Timing means making short term purchases or sales of Mutual Fund shares contrary to the Mutual Fund prospectus, policies, limitations, agreement or procedures, or contrary to or in violation of any state, federal, local or foreign statute or regulation, including but not limited to:

   (1) waiving redemption fees associated with Short-Term Trading contrary to the Mutual Fund's prospectus, policies, limitations, agreements or procedures;

   (2) acting inconsistently with written or oral representations regarding the permissibility of Short-Term Trading or the Mutual Fund's efforts to monitor or prevent Short-Term Trading;

   (3) receiving fees or other compensation in exchange for providing some investors with Short-Term Trading privileges that were not available to other investors; or

   (4) failing to monitor, detect, prevent, identify or remediate Short-Term Trading.

Mutual Fund means any organization registered as an investment company under the Investment Company Act of 1940, as amended, including any portfolio of any such company, or the equivalent of such investment company or portfolio in any jurisdiction outside the United States of America, its territories or possessions.

Short-Term Trading means the redemption of shares of a Mutual Fund in a time period less than that provided in a Mutual Fund prospectus, or the policies, limitations, agreement or procedures of a mutual fund, or at law, including without limitation any “in and out” trading of Mutual Fund shares or any other trade of Mutual Fund shares designed to take advantage of inefficiencies in the method the Mutual Fund uses to price its shares.

Directed Brokerage means paying, providing, receiving or accepting fees, commissions, bonuses, gratuities, expenses, services or any other form of revenue or compensation in exchange for the preferential treatment of a particular Mutual Fund or particular class of Mutual Fund shares.

All other terms and conditions of this **Policy** remain unchanged.

_____

Authorized Representative

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

Named Insured [redacted]			Endorsement Number
Policy Symbol **DON**	Policy Number [redacted]	Policy Period **06/01/2017 to 06/01/2018**	Effective Date of Endorsement **06/01/2017**
Issued By (Name of Insurance Company) [redacted]			

Breakpoint Exclusion

It is agreed that Section IV of the **Policy**, Exclusions, is amended by adding the following exclusion:

- alleging, based upon, arising out of, or attributable to a failure of any **Insured** to provide a discount (or discounts) on volume purchases of mutual fund shares (so-called "breakpoints").

All other terms and conditions of this **Policy** remain unchanged.

Authorized Representative

DELETE COVERAGE FOR NEW YORK REGISTERED REPRESENTATIVES ENDORSEMENT
ALLOCATION PROVISION SPECIFIED PERSON CARVE-OUT

Named Insured [redacted]			Endorsement Number
Policy Symbol **DON**	Policy Number [redacted]	Policy Period **06/01/2017 to 06/01/2018**	Effective Date of Endorsement **06/01/2017**
Issued By (Name of Insurance Company) [redacted]			

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

THIS ENDORSEMENT MODIFIES INSURANCE PROVIDED UNDER THE FOLLOWING:

SECURITIES BROKER-DEALER PROFESSIONAL LIABILITY INSURANCE POLICY

It is agreed that the **Policy** is amended as follows:

1. Section III, Definitions, subsection I, **Insured Registered Representative**, is amended by adding the following at the end thereof:

   In no event, however, shall an **Insured Registered Representative** include a **New York Registered Representative**. Notwithstanding any of the terms of this **Policy** which might be construed otherwise, no coverage shall be provided under this **Policy** to any **New York Registered Representative**.

2. Section III, Definitions, is amended to add the following:

   - **New York Registered Representative** means any natural person not an employee of the **Insured Broker-Dealer** domiciled or residing in, or a citizen of, the State of New York, who, on, prior to, or after the inception date of this **Policy**, is, was, or becomes a duly licensed and registered representative or registered principal of the **Insured Broker- Dealer**; provided, however, that the following person shall not be considered a **New York Registered Representative** for purposes of this endorsement:

     ADD PERSON'S FULL NAME

3. Section IV, Exclusions, is amended by adding the following exclusion:

   - Based upon, arising out of, or attributable to, directly or indirectly, in whole or in part, any **New York Registered Representative,** or any **Wrongful Act** committed or allegedly committed by any **New York Registered Representative**.

   - Brought by, on behalf of, or in the right of, or made against any **New York Registered Representative**, the successors or assigns of any **New York Registered Representative**, or, in the event of the **New York Registered Representative's** bankruptcy, the trustee in bankruptcy; or brought by, on behalf of, or in the right of, or made against any enterprise, trust or other entity that is operated or managed or owned, directly or indirectly, in whole or in part, by any **New York Registered Representative**; or for which any **New York Registered Representative** is a trustee, fiduciary, director or officer thereof.

4. The following provision is added to the **Policy**:

ALLOCATION

In connection with any **Claim**:

(i) made and continuously maintained exclusively against **Insureds**, this **Policy** shall provide coverage for 100% of otherwise covered **Loss** incurred by the **Insureds**, subject to all other terms, conditions, limitations and exclusions of this **Policy** and all endorsements thereto (whether any such endorsement precedes or follows this endorsement);

(ii) not made against any **Insureds**, but made against any **New York Registered Representative(s)**, this **Policy** shall not provide any coverage for **Loss**;

(iii) made against any **Insured(s)** and any **New York Registered Representative(s)**, but only if and during the time that such **Claim** is made and continuously maintained against an **Insured**, this **Policy** shall pay __% of any otherwise covered **Loss** consisting of:

a. **Defense Costs** jointly incurred by;

b. joint settlement entered into in compliance with Section II, Defense, Investigation And Settlement, by; or

c. judgment of joint and several liability against,

the **New York Registered Representative(s)** and any **Insured(s)**.

All other terms and conditions of this **Policy** remain unchanged.

AUCTION RATE SECURITIES EXCLUSION

Named Insured [redacted]			Endorsement Number
Policy Symbol **DON**	Policy Number [redacted]	Policy Period **06/01/2017 to 06/01/2018**	Effective Date of Endorsement **06/01/2017**
Issued By (Name of Insurance Company) [redacted]			

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

THIS ENDORSEMENT MODIFIES INSURANCE PROVIDED UNDER THE FOLLOWING:

SECURITIES BROKER-DEALER PROFESSIONAL LIABILITY INSURANCE POLICY

It is agreed that Section IV, Exclusions, is amended by adding the following:

- based upon, arising out of, or attributable to, in whole or in part, directly or indirectly, any **Professional Service** related to or involving, in whole or in part, any auction rate security.

All other terms and conditions of this **Policy** remain unchanged.

ADDITIONAL INSURED – VICARIOUS LIABILITY ONLY
CLAIMS BROUGHT BY - EXCLUDED

Named Insured [redacted]			Endorsement Number
Policy Symbol **DON**	Policy Number [redacted]	Policy Period **06/01/2017 to 06/01/2018**	Effective Date of Endorsement **06/01/2017**
Issued By (Name of Insurance Company) [redacted]			

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

THIS ENDORSEMENT MODIFIES INSURANCE PROVIDED UNDER THE FOLLOWING:

SECURITIES BROKER-DEALER PROFESSIONAL LIABILITY INSURANCE POLICY

It is agreed that the **Policy** is amended as follows:

1. Section III, Definitions, subsection G, **Insured**, is amended to include the following entity(ies):

   2 Proud Americans

   provided that such entity(ies) is/are only covered for **Claims**:

   (a) for vicarious or imputed liability of such entity(ies) resulting solely from the covered **Wrongful Acts** committed or allegedly committed solely by another **Insured**; and

   (b) only so long as such **Claim** is made and maintained concurrently against another **Insured**.

At no time shall coverage be afforded for the **Wrongful Acts**, acts, errors or omissions of the above-listed entity(ies).

2. Section IV, Exclusions, is amended by adding the following:

   - brought by, on behalf of, in the right of, or at the direction of the above-listed entity(ies) or any of its/their subsidiaries, or any director, officer, partner, principal, employee, agent or representative of such entity(ies) or any such subsidiary, or any successors or assignors of any of the foregoing.

All other terms and conditions of this **Policy** remain unchanged.

SPECIFIED INDIVIDUALS AND ENTITIES EXCLUSION
MADOFF, STANFORD, AGAPE, WESTRIDGE, PETTERS, GEMINI, DISP, PEARLMAN, HEALTH & ASSOCIATES

Named Insured [redacted]			Endorsement Number
Policy Symbol **DON**	Policy Number [redacted]	Policy Period **06/01/2017 to 06/01/2018**	Effective Date of Endorsement **06/01/2017**
Issued By (Name of Insurance Company) [redacted]			

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

THIS ENDORSEMENT MODIFIES INSURANCE PROVIDED UNDER THE FOLLOWING:

SECURITIES BROKER-DEALER PROFESSIONAL LIABILITY INSURANCE POLICY

It is agreed that Section IV, Exclusions, is amended by adding the following exclusion:

- alleging, based upon, arising out of, or attributable to, in whole or in part, directly or indirectly, the **Insured's** association with or business dealings with any one or more of the following:

  (a) Bernard L. Madoff, Bernard L. Madoff Investment Securities, Bernard L. Madoff Investment Securities LLC, Bernard L. Madoff Investment Securities LLC 401k Plan, Madoff Limited, Madoff Securities International Limited, Stanford International Bank Limited, Stanford Group Company, Stanford Financial Group, Stanford Capital Management LLC, Agape World, Inc. , Westridge Capital Management, Petters Co. , Gemini Fund I LP, DISP LLC, Louis Jay Pearlman, and/or Health & Associates; and/or

  (b) Any subsidiary, parent, company, corporation, partnership, limited liability company, or other entity directly or indirectly owned or controlled by or associated or affiliated with any of the persons or entities specified in (a) above

All other terms and conditions of this **Policy** remain unchanged.

ADDITIONAL INSURED
REGISTERED INVESTMENT ADVISORS

Named Insured [redacted]			Endorsement Number
Policy Symbol **DON**	Policy Number [redacted]	Policy Period **06/01/2017 to 06/01/2018**	Effective Date of Endorsement **06/01/2017**
Issued By (Name of Insurance Company) [redacted]			

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

THIS ENDORSEMENT MODIFIES INSURANCE PROVIDED UNDER THE FOLLOWING:

SECURITIES BROKER-DEALER PROFESSIONAL LIABILITY INSURANCE POLICY

It agreed that Section III, Definitions, subsection G, **Insured**, is amended to include the following solely in its/their capacity as **Registered Investment Advisors**:

[redacted]

It is further agreed that with respect to any **Claim** made against any of the entities listed above, the Retention stated in Item 5a of the Declarations page shall apply. If a **Claim** is asserted against both an entity listed above and an **Insured Registered Representative**, then the applicable **Retention** shall be the greater of the amounts stated in Item 5 of the Declarations.

All other terms and conditions of this **Policy** remain unchanged.

AGGREGATE LIMIT OF LIABILITY INCREASED
RETROACTIVE DATE AMENDED

Named Insured [redacted]			Endorsement Number
Policy Symbol **DON**	Policy Number [redacted]	Policy Period **06/01/2017 to 06/01/2018**	Effective Date of Endorsement **06/01/2017**
Issued By (Name of Insurance Company) [redacted]			

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

THIS ENDORSEMENT MODIFIES INSURANCE PROVIDED UNDER THE FOLLOWING:

SECURITIES BROKER-DEALER PROFESSIONAL LIABILITY INSURANCE POLICY

It is agreed that Item 3, Limits of Liability, of the Declarations, paragraph c., is amended by increasing the Maximum **Policy** Aggregate Limit of Liability as follows:

		Original Limit (as reflected on Declarations)	Amount of Increase in Limits	Increased Limit
a.	Maximum **Policy** Aggregate:	$ 1,000,000	$1,000,000	$2,000,000

provided, however, that the Amount of Increase in Limits specified above shall only be available to pay **Claims** first made on or after 12:01a.m. on [DATE] (hereinafter, "**Effective Date**"). Coverage afforded for **Claims** first made prior to the **Effective Date**, and for all **Claims** made on or after the **Effective Date** that, pursuant to Section VIII, Limit Of Liability, Retention And Coinsurance, subsection A, are deemed to be the same **Claim** as a **Claim** first made prior to the **Effective Date**, will be subject to the original Maximum **Policy** Aggregate Limit of Liability, as set forth in Item 3.c. of the Declarations unaffected by this endorsement. The Amount of Increase in Limits specified above shall not be available to pay any such **Claims**.

It is further agreed that, solely with respect to the Amount of Increase in Limits specified above, Item 7, **Retroactive Date**, of the Declarations page is amended as follows:

Item 7. **Retroactive Date**: 06/01/2013

All other terms and conditions of this **Policy** remain unchanged.

ADDITIONAL INSURED

Named Insured [redacted]			Endorsement Number
Policy Symbol **DON**	Policy Number [redacted]	Policy Period **06/01/2017 to 06/01/2018**	Effective Date of Endorsement **06/01/2017**
Issued By (Name of Insurance Company) [redacted]			

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

THIS ENDORSEMENT MODIFIES INSURANCE PROVIDED UNDER THE FOLLOWING:

SECURITIES BROKER-DEALER PROFESSIONAL LIABILITY INSURANCE POLICY

It is agreed that the **Policy** is amended as follows:

1. Section I, Insuring Agreements, is amended by adding the following at the end thereof:

   C. The Insurer shall pay on behalf of the **Additional Insured**, **Loss** which the **Additional Insured** becomes legally obligated to pay by reason of any **Claim** first made against the **Additional Insured** during the **Policy Period**, or any applicable **Extended Reporting Period**, and reported in writing to the Insurer during the **Policy Period** or, if exercised, the **Extended Reporting Period** in accordance with the terms of this **Policy**, for any **Wrongful Acts** by the **Additional Insured** in rendering or failing to render **Professional Services** on behalf of the **Insured Broker-Dealer**, provided such **Wrongful Acts** take place after the **Retroactive Date** but before the expiration of the **Policy**.

2. Section III, Definitions, subsection G, **Insured**, is amended to include the following:

   - Triump Insurance Advisor, Inc.

     (referred to herein as "**Additional Insured(s)**")

3. Section III, Definitions, subsection B, **Approved Activity** and subsection R, **Wrongful Act**, are deleted in their entirety and replaced with the following:

   B. **Approved Activity** means a service or activity performed by the **Insured Registered Representative** or **Additional Insured** on behalf of the **Insured Broker-Dealer** which:

   1. Has been approved by the **Insured Broker-Dealer** to be performed by the **Insured Registered Representative** or **Additional Insured**; and
   2. Is performed in connection with the purchase or sale of securities which have been approved by the **Insured Broker-Dealer** to be transacted through the **Insured Registered Representative** or **Additional Insured**, or in connection with the purchase and sale of insurance products which have been disclosed to the **Insured Broker-Dealer** by the **Insured Registered Representative** or **Additional Insured** as an outside business activity and which have, as such, been approved by the **Insured Broker-Dealer**; and
   3. For which the **Insured Registered Representative** or **Additional Insured** has obtained all licenses required by the **Insured Broker-Dealer** or applicable law or regulation.

   R. Wrongful Act means any actual or alleged negligent act, error or omission by the **Insured Broker-Dealer** and/or the **Insured Registered Representatives** and/or the **Additional Insured** in connection with the rendering of **Professional Services**.

4. Section IV, Exclusions, subsections A, E, F, W, BB, DD and FF are amended by adding "or **Additional Insured**" immediately after "**Insured Broker-Dealer**."

5. Section IV, Exclusions, subsection Z is deleted in its entirety and replaced with the following:

   Z. Based upon, arising out of, or attributable to any activities of, or services provided by an **Insured Registered Representative** or **Additional Insured** which is not a **Professional Service** rendered on behalf of the **Insured Broker-Dealer**, including, but not limited to, **Claims** against the **Insured Broker- Dealer** and/or the **Insured Registered Representatives** and/or the **Additional Insured** arising out of or in any way relating to the "outside business activities" of, or "selling away" (as generally defined in (NASD) Notices to Members No. 01-79) by an **Insured Registered Representative** or an **Additional Insured**.

6. Section IV, Exclusions, is amended by adding the following:

   - alleging, arising out of, based upon or attributable to any **Wrongful Act** by any **Additional Insured** occurring on or before the effective date on which coverage was first provided and continuously renewed and maintained for such **Additional Insured** under this **Policy** or any policy of which this **Policy** is a continuous renewal, if on or before such date any **Insured** knew or could have reasonably foreseen that such **Wrongful Act** could lead to a **Claim**, or alleging, arising out of, based upon or attributable to any subsequent **Interrelated Wrongful Act**.

   - alleging, arising out of, based upon or attributable to any prior or pending litigation, or administrative or regulatory proceeding, demand letter or formal or informal investigation or inquiry which was filed or commenced against any **Additional Insured** on or before the effective date on which coverage was first provided and continuously renewed and maintained for such **Additional Insured** under this **Policy** or any policy of which this **Policy** is a continuous renewal, or the same or substantially the same **Wrongful Act**, fact, circumstance or situation underlying or alleged therein.

7. Section XVIII, Estates, Legal Representatives and Spouses, is deleted in its entirety and replaced with the following:

   XVII. ESTATES, LEGAL REPRESENTATIVES AND SPOUSES

   The estates, heirs, legal representatives, assigns and spouses of **Insured Registered Representatives** and **Additional Insureds** shall be considered **Insureds** under this **Policy**, but coverage is afforded to such estates, heirs, legal representatives, assigns and spouses only for **Claims** arising solely out of their status as such and, in the case of a spouse, where such **Claim** seeks damages from marital community property, jointly held property or property transferred from the **Insured Registered Representative** or the **Additional Insureds** to the spouse. No coverage is provided for any **Wrongful Act** of an estate, heir, legal representative, assign or spouse. All terms and conditions of this **Policy**, including without limitation the **Self-Insured Retention**, Coinsurance and Limits of Liability shall also apply to **Loss** incurred by such estates, heirs, legal representatives,

8. Solely with respect to the **Additional Insured(s)** specified above:

   a. The Retention stated in Item 5a of the Declarations page applicable to the **Insured-Broker Dealer** shall apply. If a **Claim** is asserted against both an **Additional Insured** and an **Insured Registered Representative**, then the applicable **Retention** shall be the greater of the amounts stated in Item 5 of the Declarations.

   b. Item 7, **Retroactive Date**, of the Declarations page is amended as follows:

      Item 7. **Retroactive Date**: 06/01/2015

All other terms and conditions of this **Policy** remain unchanged.

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

Named Insured [redacted]			Endorsement Number
Policy Symbol **DON**	Policy Number [redacted]	Policy Period **06/01/2017 to 06/01/2018**	Effective Date of Endorsement **06/01/2017**
Issued By (Name of Insurance Company) [redacted]			

Insert the policy number. The remainder of the information is to be completed only when this endorsement is issued subsequent to the preparation of the policy.

Tenant in Common Exchange Exclusion

It is agreed that Section IV, Exclusions, is amended to add the following:

- alleging, based upon, arising out of, or attributable to, directly or indirectly, tenant in common exchanges, including but not limited to, 1031 tenant in common exchanges, any actual or attempted investment in, sale of, or servicing of, an interest in a security, partnership, real estate investment trust, product or other vehicle backed in any way by a tenant in common exchange, or the rendering or failure to render Professional Services in connection with a tenant in common exchange.

All other terms and conditions of this **Policy** remain unchanged.

Authorized Representative

TRADE OR ECONOMIC SANCTIONS ENDORSEMENT

Named Insured [redacted]			Endorsement Number
Policy Symbol **DON**	Policy Number [redacted]	Policy Period **06/01/2017 to 06/01/2018**	Effective Date of Endorsement **06/01/2017**
Issued By (Name of Insurance Company) [redacted]			

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

This insurance does not apply to the extent that trade or economic sanctions or similar laws or regulations prohibit us from providing insurance, including, but not limited to, the payment of claims. All other terms and conditions of policy remain unchanged.

Authorized Agent

[redacted]

[redacted]

NOTICE

POLICY NO. [redacted]

NAME OF INSURED: [redacted]

ADDRESS: [redacted]

We are pleased to enclose your policy for this account.

Please be advised that by binding this risk with the above referenced Surplus Lines Insurance Company, you agree that as the Surplus Lines Broker responsible for the placement of this insurance policy, it is your obligation to comply with all States Surplus Lines Laws including completion of any declarations/affidavits that must be filed as well as payment of any and all Surplus Lines taxes that must be the remitted to the State(s). We will look to you for indemnification if controlling Surplus Lines Laws are violated by you as the Surplus Lines broker responsible for the placement.

You further confirm that any applicable state requirement concerning a diligent search for coverage by admitted carriers has been fulfilled in accordance with state law.

Thank you for this placement and your regulatory compliance.

Date: 06292017

[redacted]

[redacted] Producer Compensation Practices & Policies

[redacted] believes that policyholders should have access to information about [redacted] practices and policies related to the payment of compensation to brokers and independent agents. You can obtain that information by accessing our website at http://www.aceproducercompensation.com or by calling the following toll-free telephone number: 1-866-512-2862.

U.S. TREASURY DEPARTMENT'S OFFICE OF FOREIGN ASSETS CONTROL ("OFAC") ADVISORY NOTICE TO POLICYHOLDERS

No coverage is provided by this Policyholder Notice nor can it be construed to replace any provisions of your policy. You should read your policy and review your Declarations page for complete information on the coverages you are provided.

This Notice provides information concerning possible impact on your insurance coverage due to directives issued by OFAC. **Please read this Notice carefully.**

The Office of Foreign Assets Control (OFAC) administers and enforces sanctions policy, based on Presidential declarations of "national emergency". OFAC has identified and listed numerous:

- Foreign agents;
- Front organizations;
- Terrorists;
- Terrorist organizations; and
- Narcotics traffickers;

as "Specially Designated Nationals and Blocked Persons". This list can be located on the United States Treasury's web site – http//www.treas.gov/ofac.

In accordance with OFAC regulations, if it is determined that you or any other insured, or any person or entity claiming the benefits of this insurance has violated U.S. sanctions law or is a Specially Designated National and Blocked Person, as identified by OFAC, this insurance will be considered a blocked or frozen contract and all provisions of this insurance are immediately subject to OFAC. When an insurance policy is considered to be such a blocked or frozen contract, no payments nor premium refunds may be made without authorization from OFAC. Other limitations on the premiums and payments also apply.

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ANATOMY OF AN ANNUITY CASE

Frank J. Fox

I. BARNEY'S STORY

In this presentation, I want to share with you my experience handling annuity cases. Let me start with a story, one about an annuity case I tried in Butte County, California last April. In 2016, recently-widowed Barney Thomas Williams set out to change his estate plan. He wanted to redirect the residue of his small estate to a homeless shelter in Chico, California.

Barney has a fourth-grade education and is financially unsophisticated with no prior experience with stocks, bonds, mutual funds or insurance products. Prior to her death, Barney's wife handled all of their financial affairs. Thus, revising the estate plan was basically 78-year-old Barney's first effort to manage his own affairs. It went poorly.

Barney started out by contacting American Family Legal Services (AFLS), the company listed on the original estate plan documents, and making an appointment to have a representative visit him in his Oroville home. During that first visit, Victor Pantaleoni provided Barney with a business card identifying Mr. Pantaleoni as a "Paralegal," AFLS's "Managing Partner" and a "CSA" (Certified Senior Advisor). His card disclosed license numbers for insurance licenses Mr. Pantaleoni held in California, Arizona and Nevada – but nowhere mentioned the word "insurance." Instead, he positioned those license numbers under a "scales of justice" icon, next to the word "Paralegal," under the words "Living Trust" and below the name "American Family Legal Services." Seeking only a revision to this estate plan, Barney had no idea Mr. Pantaleoni was operating a "trust mill" in order to sell insurance products.

At their first meeting, Mr. Pantaleoni reviewed Barney's existing living trust, collected a check for $360 for a "trust update" and promised to return in one week. That would be the only promise he kept.

Mr. Patanleoni returned with a pile of documents to be signed. Unbeknownst to Barney, those documents included an annuity application and related documents. After all the documents were signed, Mr. Pantaleoni took Barney down to the local branch of Tri-Counties Bank and had him transfer $100,000 from his savings to his checking. They returned to Barney's home where Mr. Pantaleoni had Barney give him a blank check. After leaving, Mr. Pantaleoni made that blank check payable to National Western Life Insurance Company (NWL) for $100,000.

When Barney received the annuity, he decided he did not want it. He returned the policy to NWL within the "30 day free look" period, which entitled him to a full refund of his $100,000.00 premium. Instead of promptly refunding the premium, as required by California law, NWL notified Mr. Pantaleoni he had 5 days to "conserve" the annuity or forfeit his $9,500 commission. Mr. Pantaleoni moved quickly, insisting on another in-home meeting with Barney and using the same "estate planning" ruse to get Barney to sign another annuity application by masking the documents as necessary revisions to the estate plan. This time, however, he had Barney sign a blank sheet of paper

which Mr. Pantaleoni later used to forge a letter to NWL on Barney's behalf stating he had changed his mind and asking NWL to reissue the annuity. After Mr. Pantaleoni resubmitted the annuity application and forged letter, NWL reissued the annuity and did not refund Barney's $100,000. In reissuing the annuity, NWL did not follow its own procedures and, in fact, did not even require Mr. Pantaleoni to actually deliver the annuity.

Meanwhile, Barney waited a couple of months for NWL to return his premium. When it did not arrive, he asked a neighbor to help. Through their combined efforts, Barney learned the annuity was still in force and getting his money back now would result in the imposition of a 15% surrender penalty. He decided to wait until the anniversary date to surrender – that way he would both earn a year of interest and the surrender penalty would decline by 0.25%.

When Barney resumed his efforts to get his money back in April of 2016, Mr. Pantaleoni (believing he would forfeit his commission if the annuity were surrendered) began a harassment campaign in an effort to get Barney to keep the annuity. Barney not only proceeded with his surrender of the annuity, he complained to NWL, orally and in writing, that Mr. Pantaleoni had never explained the annuity, had interfered with Barney's efforts to get his money back and was harassing him.

Barney never intended to buy an annuity, never wanted one and returned it as soon as he received it. When NWL finally refunded Barney's money, it charged him a $14,949.41 surrender penalty, allowed Mr. Pantaleoni to retain his commission and kept Mr. Pantaleoni as an appointed agent.

In December of 2017, Barney filed a lawsuit against Mr. Pantaleoni for elder financial abuse in Butte County. After conducting an initial round of discovery, Barney filed a doe amendment adding NWL. He later filed a first amended complaint and second amended complaint. On April 19, 2019, a Butte County jury returned a verdict awarding Barney economic damages of $18,309.41, general damages of $600,000.00 and $2.5M in exemplary damages.

II. FINANCIAL ABUSE: A PROBLEM, AN OPPORTUNITY

A. THE PROBLEM

The financial elder abuse epidemic has become so widespread it is now often called "the crime of the twenty-first century." Ours is an aging society with approximately 10,000 Americans turning 65 every day – the stage is set for the problem to only get worse. According to the National Adult Protective Services Association (NAPSA), nearly 5 percent of seniors surveyed reported perceived financial mistreatment. According to the National Council on Aging, 10 percent of Americans over the age of 60 experience some abuse ***each year*** – as many as 5 million seniors annually. Financial abuse is not

only the most common form of that elder abuse, it is also the fastest growing. Yet by one estimate, only 1 in 44 victims reports the crime.[1]

While state and federal legislative bodies have enacted laws, members of the judicial branch have also addressed the problem. Cook County Illinois created "Elder Courts" – specialized courts which the American Bar Association called a workable model providing legal access for elders. California's Judicial Council, together with the University of California Irvine Medical School, created a special reference for judicial officers in an effort to facilitate a higher level of understanding of the elder abuse problem.

The magnitude and seriousness of the financial abuse problem has germinated a plethora of articles discussing and resources analyzing this problem. This presentation offers a perspective of the forms, causes and legal remedies for financial abuse from an attorney who has devoted more than a decade to representing elderly victims of financial abuse.

B. THE OPPORTUNITY

The financial elder abuse epidemic poses significant opportunities for the plaintiffs' bar. The proliferation of financial elder abuse coupled with its serious impacts on its elderly victims renders this area rife with opportunities to help victims and change or deter predatory behavior. In particular, by its very nature, financial abuse tends to have devastating psychological impacts resulting in claims which include not only financial loss but also substantial emotional distress damages – damages which are almost always a multiple of the economic losses. Thus, many of these cases also offer an opportunity to obtain a significant recovery for the attorney willing to risk his or her time to help the elderly victim. Having now practiced in this area for many years, and having handled dozens of financial elder abuse cases, we can say that most cases settle and many of settlements are in the low seven-figure range.

III. EVALUATING THE ESSENTIAL COMPONENTS OF ANNUITY CLAIM

This section summarizes the process of evaluating the essential components of an annuity claim: the client, agent, insurer, annuity product, documents and damages.

A. THE CLIENT

Getting to know the client's larger story helps identify facts and factors which may have an impact on the strength of the client's claims. In an annuity case it can be helpful to learn as much as possible about each facet of the client's life, including

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[1] The actual prevalence of financial abuse is hard to know. While one study indicates 1 in 10 older adults is abused each year (all types of abuse), another study indicates that, when swindles are included, 1 out of 5 elders is abused every year (swindles can include "inappropriate investments, unreasonably high fees for financial services, or outright fraud"). Moreover, the apparently huge under-reporting problem suggests that even those disturbing statistics may be materially understated.

childhood, family relationships, education, military service and employment history, as well as investment experience, experience with any other insurance products and financial and estate planning goals and expectations. A more thorough exploration can reveal powerful details which may help endear the client to a jury.

For example, Barney's life story reveals a difficult life. His father died when he was six months old. He spent his early years in impoverished areas of East Texas and Louisiana. To help support the family, he went to work in the cotton fields and farmyards as a child, missing much of his early school years. He left home at the age of 13 and moved to California. By 14, he was working in the grocery store where he would work for the next 27 years. The details of Barney's marital relationship, while not directly relevant to his claims, also provided facts showing the strength of his character and enhanced his credibility in the "swearing contest" at trial. Barney's wife was seriously ill for the last ten years of their marriage and was bed-ridden for the last two. Barney took care of her in their home, and took care of everything else, right up until the night she died.

There are many ways to discovery the client's story. One particularly effective approach is to stay with the client, if the client is comfortable with that kind of imposition. Sleep in an extra room. Share meals. In Barney's case, we often got up early and drank coffee together, chatting by his wood-burning stove.[2]

This process of getting to know the client can facilitate a more thorough evaluation of the client's circumstances and a better understanding of the client and his or her goals in the underlying transaction. This process also sets the stage for evaluating the client in other important respects, especially his or her susceptibility to undue influence. Understanding that susceptibility requires understanding factors like the client's financial capacity, educational background and overall investment experience.

B. THE AGENT

1. Department of Insurance Records

In an annuity case, the background research on the agent should include a review of available Department of Insurance licensing files. Most states make limited information available about agents licensed to sell insurance products in that state. Some states also make available information on any enforcement action the state may have commenced against the agent.

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[2] Credit for this approach to knowing the client goes to Jude Basile, former President of the Trial Lawyers College, who emphasizes the importance of close, extensive and meaningful contacts with client. In wrongful death cases, Mr. Basile has been known to move into the victim's home, sleep in the victim's bed and, as much as possible, live and experience the life the victim lived in the days before the event which ended that life.

In Barney's case, the agent, Mr. Pantaleoni, was the subject of an enforcement action resulting in the DOI entering an order revoking his license and issuing a restricted license in lieu thereof. As the Accusation explains, the action and resulting order were based upon Mr. Pantaleoni's unlawful conduct in an annuity transaction with a 74-year-old widow. Because the details of Mr. Pantaleoni's unlawful conduct were set forth in the Accusation, that publicly available information became a focal point in reviewing the insurance company's subsequent due diligence when it completed Mr. Pantaleoni's annuity transaction with Barney.

Department of Insurance records also include publicly available information about which companies have appointed the agent as a representative. Information identifying those other companies helps identify other more beneficial annuities the agent could have sold the client.

2. Other Litigation

Background research on an agent should include other litigation involving the agent and whether he or she has been a party to any bankruptcy proceedings. In Barney's case, Mr. Pantaleoni had not only been mentioned in a complaint alleging trust mill sales of annuity products nearly 15 years earlier, but he had also filed multiple bankruptcies. In fact, his third bankruptcy was still pending at the time of his transaction with Barney, suggesting Mr. Pantaleoni was under financial duress and experiencing a heightened level of desperation when he received the notice from NWL that he had 5 days to conserve the annuity Barney returned lest he forfeit his $9,500 commission.

3. The Agent's Businesses

Understanding an agent's sales approach and practices underscores the importance of researching any business the agent may be operating. One guidepost in this area is whether the agent provided the client with a business card, and if so, what that card says about the agent and any associated business.

In Barney's case, Mr. Pantaleoni's business card identified AFLS as his associated business, mentioned "Living Trust" and unlawfully omitted the word "insurance." Many agents use the ruse of providing estate planning services as a pretense to sell insurance products. That business card, coupled with Mr. Pantaleoni's "bait and switch" practices, revealed Mr. Pantaleoni was doing exactly that.

C. THE PRODUCT

1. The Surrender Period/Surrender Penalty/Commission

The relationship between an annuity's surrender period and surrender penalty on the one hand and an agent's commission on the other can be a strong indication of an unsuitable and predatory annuity transaction. Generally, there is a direct relationship between the length of surrender period and size of penalty, and the amount of the agent's commission – the longer the surrender period and the larger the surrender penalty, the

bigger the agent's commission (and the greater the annuity's impact on the elder's liquidity). Most insurance companies and many agents will admit the existence of this direct relationship between surrender penalty/period and commission. That relationship, the insurance company's knowledge of it and the insurance company's knowledge of products the agent could have sold but did not arguably bear heavily upon whether an insurance company knew the agent was preying on the client by selling an annuity which paid the largest commission while saddling the client with an annuity having maximum impact on loss of liquidity.

In Barney's case, NWL knew Mr. Pantaleoni was selling Barney an "Ultra Classic" annuity with a 13-year surrender period and 15% surrender penalty. NWL also knew the sale of that Ultra Classic annuity would pay Mr. Pantaleoni a 9.5% commission. Conversely, NWL knew that virtually all of its other annuity products had shorter surrender periods, had smaller surrender penalties and, consequently, paid smaller commissions.

2. Illusory Benefits

Some insurance companies attempt to justify their worst annuities by claiming the annuity offers some special "benefit" to the client. These "benefits," however, can be completely illusory.

In Barney's case, NWL repeatedly attempted to justify the sale of its Ultra Classic annuity by touting the annuity's "lifetime income" benefit, a very complicated provision which, under certain circumstances, guaranteed Barney income for life. Obviously, insurance companies are not in business to lose money; they have actuarial specialists to design contracts so they make money. As one insurance expert has explained, an annuity is simply a contract written by the company by which it obtains your money, keeps your money and returns it to you a little at a time under a design intended to allow the insurance company to keep as much of your money as possible for as long as possible.

The lifetime income benefit in Barney's annuity was highly unlikely to ever be of any benefit to him. First, the rider came at a cost – an annual fee. Second, the benefit was limited to an amount which would have required Barney to live another 14 years to get just his $100,000 back, not to mention any purported interest that supposedly accrued on the $100,000. At 78, Barney only had a life expectancy of 9.2 years. And, there were other terms in the annuity that allowed Barney to withdraw up to 10% per year without having to pay any annual charges. In other words, the Ultra Classic's so-called lifetime income benefit was simply illusory.

D. TRANSACTION DOCUMENTS

In evaluating an annuity case, it is also important to carefully review both the annuity application and suitability questionnaire. Many insurance companies attach a copy of the completed application to the policy before it is issued. Hence, if the client has the policy, he or should is likely to also have the application which often includes the questionnaire.

In reviewing the application and suitability questionnaire, pay attention to signatures and initials and ask the client whether they are valid. Ask the client, too, whether the handwriting on those documents is his or hers and, if not, ask whether the documents were filled out in the client's presence or whether they were even filled out before the client was asked to sign.

Because suitability is a requirement for annuity transactions, pay particularly close attention to the questionnaire and try to determine if the information is accurate, consistent and sufficient. In some predatory and unsuitable annuity transactions, the suitability information on the questionnaire is inaccurate. This may be because many insurance companies provide their agents with suitability guidelines which tells the agent the minimum thresholds for finding a transaction suitable, e.g., annual income cannot be below a certain amount, or the amount of the annuity cannot decrease the client's liquidity by more than certain percentage. Armed with that information, an unscrupulous agent can falsify answers on the suitability questionnaire, making a plainly unsuitable transaction appear suitable. The client is required to sign the questionnaire and attest to the accuracy of the information. For too many, the annuity transaction is too confusing and overly-trusting clients end up just following the agent's directions to "sign here" and "sign here," never really getting a meaningful opportunity to review or understand what they have signed.

Again, do not assume that answers in the suitability questionnaire are accurate, consistent or sufficient. And do not assume the insurance company carefully reviews the questionnaire. In Barney's case, Mr. Pantaleoni overstated Barney's annual income, assets and investment experience. Together, those overstatements made NWL's approval of the proposed transaction as suitable more likely. Mr. Pantaleoni, however, also concocted answers to two questions bearing on net assets and net liquid assets after the transaction (questions 4 and 9) and those two answers conflicted irreconcilably. NWL apparently overlooked or at least ignored that irreconcilable conflict. It approved Barney's transaction without ever following up on the inconsistency or otherwise reconciling the conflicting information.

E. ANNUITY SUITABILITY

By law, annuity suitability is a prerequisite to an agent's recommendation of an annuity and a prerequisite to an insurer's issuance of the annuity. For example, in California, an agent is prohibited from recommending an annuity unless there is a reasonable basis to believe the annuity is suitable based upon the client's suitability information. Correspondingly, an insurer is prohibited from issuing an annuity unless there is a reasonable basis to believe the annuity is suitable based upon the client's suitability information. Suitability information is a defined term and generally includes (but is not limited to) the client's age, annual income, financial situation and needs, financial experience, financial objectives, intended use of annuity, financial time horizon, existing assets, liquidity needs, liquid net worth, risk tolerance and tax status. In California, the term "suitability information" also includes whether the client has a reverse mortgage or intends to apply for means-tested government benefits.

While the laws governing suitability vary slightly from jurisdiction to jurisdiction, the majority of states subscribe to the suitability regulations issued by the National Association of Insurance Commissioners (NAIC). Some states have enacted their own statutory suitability requirements for annuity transactions which generally follow the NAIC regulations but include some material deviations (e.g., California Insurance Code (CIC) §§10509.910-10509.918.)

These requirements can be important standards to review and apply. Notwithstanding the importance of such suitability requirements, you should not assume the insurance company has carefully adhered to them, not even at the most basic level. In one annuity case we handled last year, the suitability questionnaire which had been used in California for nearly four years failed to request and obtain from the client almost half of the required suitability information. Arguably, all of the annuity transactions that insurance company had completed in California were unlawful because the insurance company had not obtained all of the required suitability information and thus, as a matter of law, could not have had a reasonable basis to believe the annuity was suitable based upon the consumer's suitability information.

IV. COMMON DEFENSE STRATEGIES/ARGUMENTS

Defendants, and particularly insurance companies, mount a variety of arguments in an effort to avoid liability, including one or more of the following:

A. THE AGENT WAS THE *CLIENT'S* AGENT

Citing inapposite cases like *Mercury Insurance Co. v. Pearson* (2008) 169 Cal.App.4th 1064 (an auto insurance case), and *Eddy v. Sharp* (1988) 199 Cal.App.3d 858, some insurance companies argue that, where the insurance agent is not a captive or exclusive agent of the insurance company, that agent is actually the client's agent, not the company's. One flaw in this argument is that, in an annuity transaction, NAIC suitability regulations and corresponding state annuity suitability statutes supersede cases like *Mercury* and *Eddy* to make the agent the company's "producer" and saddle the insurer with the responsibility to supervise and train those producers. Those same regulations and statutes (e.g. CIC §10509.916) also make the insurer responsible for the producer's violations.

B. THE CLIENT FAILED TO CONSULT ATTORNEY/CPA

In California, insurers are required to provide prospective insureds with a notice telling them that a transaction can have tax and other legal consequences and recommend they consult with an attorney and CPA before proceeding. Then they point to the client's failure to consult with such a professional as contributory negligence which should reduce if not bar the alleged damages.

C. THE CLIENT UNDERSTOOD THE TRANSACTION, HAS "BUYER'S REMORSE" AND WANTS A "DO-OVER"

Annuity transactions include many documents which require the client's signature. Above many of those signature blocks are statements confirming that, by signing, the client acknowledges receiving, reading and understanding the document, the transaction has been explained to him or her, and he or she understands the transaction. Those signatures then become the foundation for the insurance company's argument that the client has just changed his or her mind and wants to unwind the transaction because of plain old "buyer's remorse."

D. THE CLIENT SIGNED AND IS BOUND – AKA "A DEAL IS A DEAL"

A corollary to the last argument is the age old principle that a deal is a deal – a client who signs a contract is bound by it. This argument is often buttressed by caselaw declaring that parties are expected to read and understand a contract before signing it and thus they sign it at their own risk.

E. THE ANNUITY IS BENEFICIAL

In many cases the insurance company or agent attempts to sell an annuity by arguing it provides significant benefits and constitutes a better option than the client's other alternatives.

F. AGENT MISLED INSURER TOO

Pointing to the agent's dishonest acts, insurer's may argue they, too, were misled and victimized by the agent. Correspondingly, they will argue those dishonest acts were prohibited by their agreement with the agent and were outside the scope of the agent's engagement.

V. PLEADING – THE COMPLAINT

A. COMMON LAW REMEDIES

Remedies under several common law theories may be available depending upon the particular circumstances, including one or more of the following:

- **Negligence**: The available remedies may include breach of a duty of care, enabling recovery of compensatory damages for which such negligence was a substantial cause, and remedies based upon negligence *per se* where the conduct at issue violated a statute enacted to protect a class (as explained below, elders are members of a protected class) and prevent the type of harm the elder suffered.

- **Fraud:** Many forms of financial abuse fit within the common law definition of fraud and may entitle an elder to compensatory damages as well as exemplary damages where the fraud was committed with malice or oppression.

- **Breach of Fiduciary Duty**: Where the financial abuses arises from circumstances indicating the existence of a "special relationship" between an elder and an abuser, the latter's abusive conduct may constitute a breach of a fiduciary duty.

- **Conversion**: By definition, much of the financial abuse which involves the taking of tangible property constitutes a "conversion" of an elder's property and may give rise to an action for conversion.

B. GENERAL STATUTORY REMEDIES

Many states have statutes of general application which provide a private right of action and may encompass financial abuse. For example:

- **Consumer Protection Statutes**: California's Consumers Legal Remedies Act prohibits 26 different unlawful acts and practices and provides enhanced remedies where the victim is a senior.

- **Unfair Competition Statutes**: California's Business & Professions Code includes an Unfair Competition Act (UCL) which is designed to protect against deceptive business practices, including deceptive advertising. The UCL allows consumer claims, including consumer class actions, provided the consumer can show loss of money or property as a result of the deceptive business practice/unfair competition. Its remedies are generally limited to restitution and injunctive relief but the UCL also provides for civil penalties, payable to the state, where the unfair competition is targeted at seniors.

- **Regulatory Statutes**: Regulatory statutes such as those which regulate the insurance industry may also provide protections and remedies for elders. For example, California's Insurance Code contains a series of "Senior Insurance Provisions" which include a provision imposing upon the insurer and its agent a duty of honesty, good faith and fair dealing when dealing with a prospective insured over the age of 65.

C. SPECIFIC STATUTES ENACTED TO PROTECT ELDERS

Many states have enacted laws specifically designed to address the elder abuse problem. This section will summarize pertinent provisions of California's *Elder Abuse and Dependent Adult Civil Protection Act* (Elder Abuse Act) (California Welfare & Institutions Code §15600 *et seq.*). California enacted the Elder Abuse Act in 1982 and has repeatedly amended and strengthened its protective provisions. Premised upon a series of findings and declarations, the Elder Abuse Act recognizes elders'

and dependent adults' vulnerability to abuse, expressly declares the State's responsiblity to protect them and includes both incentives and enhanced remedies. As a remedial statute, the Elder Abuse Act is to be liberally construed on behalf of the class of persons it is designed to protect. *Mahan v. Charles W. Chan Ins. Co.* (2017) 14 Cal.App.5th 841, 860-61.

1. The Elder Abuse Act's Broad Definition Of "Financial Abuse?"

Under the Elder Abuse Act, financial abuse occurs whenever a person or entity does, *or assists*, any of the following:

- takes, secretes, appropriates, obtains or retains an elder's interest in real or personal property for a wrongful use or with intent to defraud or both; OR

- does any of the above described acts through "undue influence" as defined in the Elder Abuse Act.

2. The Conclusive Presumption Of Financial Abuse

In 2008, the California Legislature amended the definition of financial abuse, effectively creating a conclusive presumption of "financial abuse" whenever a person or entity obtaining the elder's property knew, or should have known, their conduct was likely to be harmful to the elder. The conclusive presumption of "financial abuse" arguably extinguishes the doctrine of *caveat emptor* in transactions with California's elders. By adding "or should have known," the Legislature expanded the definition of financial abuse to encompass negligent conduct – a person's or entity's conduct does not need to be intentional to be actionable as financial abuse.

3. What Actions Constitute "Taking" Property

Under the Elder Abuse Act's definition of "financial abuse," a person or entity takes, secretes, appropriates, obtains or retains an elder's property whenever an elder is deprived of any property right. The definition of taking, etc., also reaches actions accomplished by means of an agreement, a donative transfer or a testamentary bequest. It does so without regard to whether the property is held directly by an elder or by the elder's representative.

4. The Elder Abuse Act's Heightened Remedies For Financial Abuse

The Elder Abuse Act provides a financially-abused elder with the following enhanced remedies:

- "[C]ompensatory damages and all other remedies provided by law;"

- A unilateral mandatory right to recover reasonable attorneys' fees and costs;[3]
- A right to obtain a restraining order;
- A right to obtain a writ of attachment without showing the claim is for money, based upon a contract for a fixed or readily ascertainable amount not less than $500.00, unsecured or secured by personal property and a commercial claim.

D. OTHER CONSIDERATIONS

1. Civil Rights Violation

The Elder Abuse Act declares elders are a disadvantaged class, prohibits all forms of abuse of elders and establishes that California has a responsibility to protect them. Tax attorney Robert Wood, who has written on the tax consequences of settlements and judgments, has explained that those legislative findings are helpful to the argument that an elder abuse claim is a civil rights claim. If so, a judgment or settlement of a financial abuse claim may be entitled to more favorable tax treatment.

2. Intentional Versus Negligent Conduct

Often a client's best hope of recovery from an agent is through the agent's errors and omissions insurance. E&O insurance, however, generally does not indemnify intentional conduct. For that reason, consider the extent to which pleading and proving negligent conduct, rather than intentional conduct, is in your client's best interests. This consideration, of course, generally does not apply to claims against the insurer, which are self-insured or otherwise sufficiently solvent to satisfy an award for exemplary damages.

3. Serving The CEO/General Counsel

In addition to serving the insurer's registered agent for service of process, consider serving copies of the complaint upon the insurer's CEO and General Counsel. Doing so arguably provides them with notice of the agent's unlawful conduct in the underlying transaction. That knowledge may support a ratification argument if the insurer fails to terminate the agent and/or refund the "fruits" it obtained from the agent's unlawful conduct.

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[3] An elder's unilateral right to recover attorneys' fees "trumps" a prevailing party's contractual right. *Wood v. Santa Monica Escrow Co.* (2007) 151 Cal.App.4th 1186). In *Wood*, the court not only affirmed a prevailing elder's unilateral right to recover attorneys' fees, it went on to hold that, where each of the plaintiff's claims, including the elder abuse claim, arose from a single transaction, the Elder Abuse Act precludes any award of attorneys' fees to a prevailing defendant, even as to the non-elder abuse claims. Notably, the court reached this conclusion even though the plaintiff in *Wood* voluntarily dismissed his claims, and the prevailing defendant claimed a contractual right to attorneys' fees for defense of plaintiff's tort claims. *Wood* at p. 1190.

VI. DISCOVERY

This section briefly summarizes some of the more important informational targets of discovery in an annuity case. It is by no means an exhaustive list but the following are starting points and the responses should help reveal other areas for inquiry.

A. DOCUMENT REQUESTS

1. Agent File

The agent's file should include important documents like the insurer's agreements with the agent (including commission schedules on the products the agent sells), records of the agent's training, compliance bulletins the agent has been provided and other general correspondence with the agent. Documents like the agreements help establish the insurer's right to inspect the agent's files and other ways in which the insurer may be able to exercise control over the agent (e.g., the right to inspect agent's business card). Because some insurers may keep one or more of these documents in separate files, consider supplementing the request for the agent's file with separate requests for agreements with the agent, all commission schedules on the products the agent sells, all records reflecting the agent's training and all compliance bulletins provided to the agent.

2. Policy File

The policy file should include a copy of the annuity policy, all of the transactional documents and all communications with the client or agent related to the policy. Again, consider supplementing the request for the policy file with separate requests for all of the transactional documents and communications. As to the latter, be sure to define communications to include recorded conversations. Most insurance companies record their conversations with their consumers and agents.

3. Underwriting/Suitability File

As noted, confirming the suitability of the annuity is an important prerequisite to its issuance. Insurers and agents are generally required to document and maintain records reflecting their compliance with this requirement. Because they may not label a file containing these records a "suitability file," be sure your requests are broad enough to encompass such records no matter how they are labeled.

4. Required Notices

Depending upon the age of the client, and the applicable law, the insurer and/or its agent may be required to provide the client with particular notices as part of the transaction. Examples include the following:

a. In-home senior meeting notice. Sometimes called the "24 hour notice," this notice may be statutorily required whenever an agent will be meeting with a senior in the senior's home. It is generally required to be provided

24 hours in advance of the meeting and state that the agent is an insurance agent, the sale of insurance products will be discussed and that senior is entitled to terminate the meeting and have the agent leave at any time.

b. California Medi-Cal notices. In California, many annuities are sold for the purpose of helping the client qualify for Medi-Cal. The content of these notices are prescribed by statute and are designed to inform the client about Medi-Cal. A related statute prohibits the sale of an annuity for Medi-Cal purposes if the client already qualifies for Medi-Cal or will not qualify for Medi-Cal after purchasing the annuity.

5. Complaints

Inquiring about other complaints the insurer received about the agent can also lead to relevant information which arguably may bear upon an insurer's conscious disregard for its prospective insureds' rights and safety.

B. INTERROGATORIES

1. Meetings/Communications

Flush out and obtain all information about the date, time, place, attendees and substance of (including any documents reviewed or provided) at any relevant meetings. These include any meetings the client had with the agent or any one else in connection with the transaction.

2. Training

As noted, some statutes (e.g. CIC §10509.914-§10509.915) require insurers to train and supervise agents and such training is supposed to include "product specific" training. Records of training, and the specfic substance of any training provided, can help establish both the insurer's and insured's violations and their knowledge.

3. Other Annuity Products

Understanding what other annuity products the insurer offers can be helpful to demonstrating the insurer knew the agent had selected a product that paid her or him the largest commission while saddling the client with the worst annuity in terms of guaranteed returns, surrender period and surrender penalty.

C. ADMISSION REQUESTS

1. Authentication of Documents

Because of the evidentiary importance of the transactional documents, it is important to authenticate them before trial. Using admission requests is one relatively easy way of doing this.

2. Transaction Facts

Use admission requests to establish as undisputed the operative facts of the transaction, including the dates and places of meetings, the product sold, the alternative products that were available and could have been sold, the amount of the premium received, the amount of the commission paid and any particularly relevant information known to the agent or insurer at the time of the transaction.

3. Ultimate Facts

It may also be worth including ultimate facts, e.g., "You committed financial abuse when you sold the Annuity to [client]," and/or "You committed fraud when you sold the Annuity to [client]," and/or "You committed negligence when you sold the Annuity to [client]." Including such requests may provide a direct avenue to establish liability in the event the agent or insurer fails to respond and the requests are deemed admitted. Mr. Pantaleoni, the agent in Barney's case made this mistake and the Court entered an order deeming admitted his commission of financial abuse, negligence and fraud. Even where the insurer and agent deny the request, you may use their denial as a vehicle for additional discovery if you serve the request with a set of interrogatories asking them to state all facts, and identify all documents and witnesses which support their denial.

D. DEPOSITIONS

1. Who/Sequence/Documents

In most annuity cases, the persons directly involved with the transaction or any other issue are appropriate witnesses. However, an important choice arises when deciding when to depose them *vis-a-vis* the insurer's person most qualified (PMQ), i.e., who goes first? There are pros and cons for each and determining the best sequence may depend upon the facts of the particular case. Generally, deposing the PMQ last helps ensure you will be more fully informed before deposing the insurer's representative. However, so will defense counsel and the PMQ. Conversely, deposing the PMQ early in the deposition sequence may make it harder for defense counsel to fully prepare the PMQ for all avenues of examination.

In Barney's case, NWL's PMQ was deposed before its compliance officer, licensing director and general counsel, and thus she was the first NWL witness to confront many of the issues. Another potential advantage to deposing the PMQ first, at least in California, is that, unlike other witnesses, a PMQ deposition is not subject to a strict time limit, thereby allowing for a more in-depth inquiry on many topics and thus enabling a more thorough preparation for subsequent depositions. Yet another potential advantage to deposing the PMQ early on is that, while other witnesses have no obligation to refresh their recollection while preparing for a deposition, a PMQ is obliged to avail himself or herself of available information within the topics specified in the notice, again enabling a more thorough preparation for subsequent depositions.

2. Videotape?

Videotaping a deposition adds a significant extra expense. Is it worth it? Where the insurer is headquartered out of state, rendering the insurance company representative and employees "unavailable" at trial, being able to play a videotape to the jury showing the witness's demeanor may be the only way for the jury to assess the witness's credibility (or lack thereof). In particular, videotaping the insurer's PMQ can prove especially useful. Even if the PMQ is available at trial, you may be able to play excerpts from his or her deposition (in California, a deposition of a party may be used for any purpose, not just impeachment). Those videotaped excerpts may provide a revealing contrast to the PMQ's now better-educated trial testimony. In Barney's case, the PMQ had new and better responses to some of Barney's points and arguments than she had at her deposition. Playing and contrasting her videotaped deposition testimony with her trial testimony made it clear she was changing her story.

VII. TRIAL STRATEGIES

A. *VOIR DIRE* – THE PROVERBIAL "FIRST IMPRESSION"

The *voir dire* process constitutes the jury's first impression of the parties' lawyers. While usually thought of as just the process to pick a fair jury, it also should be recognized as the beginning of your relationship with the jury. In that relationship, *nothing* is more important than your credibility. As a lawyer, establishing credibility may be an "uphill battle," at least with some jurors. So, ***be genuine*** and avoid the appearance of any "gamesmanship."

Because you are trying to get to know the jurors' attitudes and perspectives about issues they may be required to decide, invite them to be brutally honest with you when answering your questions. Then, when a juror does open up and share herself or himself with you, look her or him the eyes and thank them, genuinely, even if their contribution seems to hurt your case.

Over the months of your trial preparation, compile the "danger points" of your case – those arguments the defendants will make that you think are likely to resonate with jurors. In Barney's case, these included facts like his signing numerous documents without reading them, twice. Explore these danger points with the jury (e.g., "You may hear evidence that Mr. Williams signed documents without reading them. How do you feel about that? Is he stuck? Should we just go home?").

Other "danger points" may include jurors' attitudes about lawsuits and lawyers. Those, too, may be important and actually fruitful areas to explore. In Barney's case we asked the jury whether everybody agreed that there were too many lawsuits. Two jurors disagreed, explaining that they felt there were not enough lawsuits, that too many victims could not find a lawyer and that the big companies with all the money had the best lawyers and a big advantage.

B. OPENING STATEMENT

Showing due respect for the jurors includes showing respect for their time. Craft your opening statement with that in mind. Opening statements should be as short, simple, clear and provable as possible. Consider, too, stealing the defendants' arguments in a way which undermines their impact.

For example, in Barney's case, NWL clearly intended to show the jury that they had acted responsibly by distributing "compliance bulletins" to Mr. Pantaleoni informing him of the law and its prohibitions against conduct such as using "trust mills" or "pretextual interviews" to sell insurance products. Being a plaintiff's lawyer gives you the advantage of going first and, with it, the opportunity to present an entirely different perspective of the evidence the insurer or agent intends to discuss in their openings. Thus, in Barney's case, NWL's compliance bulletins became "CYA" memos – documents which confirmed NWL knew it was wrong to use "trust mills" or "pretextual interviews" to sell its products. Other documents, such as NWL's agreement with Mr. Pantaleoni, became evidence of NWL's "wilful ignorance" as those agreements allowed NWL access to Mr. Pantaleoni's files and records, access it never used. This opening perspective of NWL's evidence helped set the stage to establish NWL turned "a blind eye" to Mr. Pantaleoni's wrongful conduct, never exercising its rights to look at his compliance but instead simply covering itself by issuing compliance bulletins which it knew or should have known Mr. Pantaleoni was ignoring.

C. CASE IN CHIEF

1. Witness Order

The principle of primacy and recency – that people remember best what they heard first and last – suggests the importance of starting your case in chief with a strong witness. In Barney's case, he was the perfect first witness. Despite his lack ofeducation and financial sophistication, he was a strong witness. He had an unshakeable grasp of the basic facts and was careful in considering the questions before responding. Because he had done well in his deposition, we were confident he would survive cross-examination at trial.

In establishing the sequence of witnesses, consider the contrast a particular juxtaposition may provide. For example, Mr. Pantaleoni repeatedly attempted to justify and explain his sale of the annuity by claiming that Barney's step-daughter, Merrily, had physically, emotionally and financially abused Barney. According to Mr. Pantaleoni, she had broken into Barney's home, beat him up and stole things from him. At trial, we concluded the cross-examination of Mr. Pantaleoni by playing some of the videotaped excerpts from his deposition in which he made those claims. We then put Merrily on the stand to testify about how she worked 24/7 – "shoulder-to-shoulder" – with Barney during the last weeks of her mother's life, helping Barney care for mother in her final days. We had her explain her shock at finding, after her mother's death, an unsolicited, unexpected check for $5,000 on Barney's dining room table, an expression of his gratitude for helping him with her mother's funeral arrangements and helping him

navigate the post-death Social Security maze. And, we apologized for having to ask, but had she ever "beaten Barney," or "abused" him physically, emotionally or fiancially. By then the proposition of her abuse was so patently absurd, some of jurors laughed out loud at the question.

2. Avoid Repetition

After our first annuity trial (which we lost), one juror emphasized his frustration with our repetition of certain evidence. To use his words, "we don't need to hear six times 'the dog was barking at midnight' to understand the dog was barking at midnight." In crafting your case in chief consider selecting carefully which witness will make a point most credibly and then avoid the risk of having the jury feel like you are wasting their time by presenting the same point through multiple witnesses.

3. Direct Examination

Annuities and annuity transactions are inherently complex; direct examination questions should not be. Strive to keep questions simple and, when telling the story, use present tense. ("So, when you are first meeting with Mr. Pantaleoni in your home, where are you sitting?" "What are you discussing?" "What is he telling you?" "What is he showing you?") Present tense questions have the tendency to include the jury in the event: they are seeing, hearing and understanding as the event is occurring, they are there with Barney and Mr. Pantaleoni.

While it is obviously important to outline or script your direct examination questions, it is even more important to LISTEN to the witness's answers. The jury **is** listening and witnesses answers may not be what you assume them to be. Their answer, not your question, is the evidence, so make sure you hear it. With any luck, that answer includes a point you are trying to make. If so, consider echoing the point in your next question.

In scripting your direct examination, consider addressing "danger points" you expect the witness will confront in the coming cross-examination. In Barney's case, we knew the insurer had identified what it believed were certain inconsistencies between Barney's deposition testimony and his verified discovery responses.

4. Cross-Examination

Consistent with the goal of respecting the jury and not wasting its time, work to keep cross-examinations short. Here, too, in sequencing the points of cross-examination try to start and end each on clear, strong points. While portions of your cross may be outlined prior to trial, listen carefully to the direct examination as it may change your whole approach.

In Barney's trial, the insurance company engaged a very well-credentialed, extensively experienced and loquacious insurance expert. Clearly, he was going to be the keystone of their defense, blessing as perfectly appropriate their every single

act. For hours, he so testified on direct, explaining why everything the insurance company did was perfectly reasonable and consistent with the industry custom and practice. We had outlined our cross-examination in advance but, after watching his unflinching praise of such palpably problematic conduct, we revised our cross, limiting it to two questions. The first was, "Please tell the jury every mistake NWL made in this annuity transaction." Over the prior week, the jury had already seen and heard a small mountain of evidence showing NWL's plainly troubling conduct. The expert's response of "[w]ell, I wouldn't really call them 'mistakes'" spoke volumes about his objectivity.

The second question was a hypothetical based upon NWL's duty to thoroughly investigate every complaint involving the sale of an annuity in California. It was undisputed that NWL did not investigate Barney's complaints. It was virtually indisputable that, had NWL thoroughly investigate Barney's complaints, it would have learned of facts like Mr. Pantaleoni's falsification of information on the suitability questionnaire. So, we asked the expert to assume that NWL had conducted an investigation and it revealed that Mr. Pantaleoni had falsified information on the suitability questionnaire, overstating Mr. Williams's income, assets and investment experience, what should NWL have done?" His answer: NWL should have immediately given Mr. Williams back all of his money. Game over. The lesson, stay flexible, listen to the direct examination and be prepared to change your cross-examination strategy.

D. CLOSING ARGUMENT

Our closing argument strategy in Barney's trial was to retell his story using a combination of highlights from the trial testimony and ***key*** exhibits (there were over 100 exhibits, so deference to time consideration militated heavily in favor of being very selective). Ideally, this "retelling" process includes juxtaposing at least some of those testimony highlights and key exhibits against the most important jury instructions.

Closing argument also should include a careful review of any special verdict, providing and explaining the answer the jury should give to each question; however, in Barney's case, that was not possible because the parties failed to agree on the special verdict in time for effective use during our closing argument. That experience raises a final point: defendant's delay is often strategic. We often encounter dilatory moves by defendants which make presenting our case more difficult. For example, in one annuity case defendants delayed submitting their objections to our videotaped deposition excerpts, putting the Court in the position of having to rule on those objections as we played the excerpt and forcing us to carve out or omit excerpts on the fly. The point is simply that, for important components like special verdicts, you may need to raise such points early, keep track of them and make a written record of your efforts and then raise them with your judge far enough in advance to avoid being prejudiced by a defendants' failure to do what they are supposed to, when they are supposed to.

Good luck!!

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ABUSIVE SALES PRACTICES IN ANNUITIES AND LIFE INSURANCE PRODUCTS

Alan J. Besnoff, CFP, CLU, ChFC

1. UNSUITABLE REPLACEMENT OF LIFE INSURANCE PRODUCTS ("TWISTING")

WHAT IT IS:

The act of inducing or attempting to induce a policy owner to replace an existing life insurance policy with another policy by using misrepresentations, omissions or incomplete comparisons of the advantages and disadvantages of the policies to the detriment of the insured.

INDUSTRY STANDARD WHEN REPLACMENT IS APPROPRIATE:

To protect the interests of life insurance purchasers from the negative consequences of replacing existing life insurance, it is the industry standard to avoid recommending replacement of existing life insurance ***unless any benefits will clearly outweigh the high costs and other negative, irreversible consequences of the transaction***.

The California Department of Insurance warns consumers to "[b]eware of any agent who suggests that using the cash value from your current policy to fund the premiums on a new policy offers a demonstrable advantage to you . . . ."[1]

Additionally, the Director of the Arizona Department of Insurance has issued guidance stating "[b]ecause there are significant penalties for early termination of both life and annuity contracts, it is imperative that consumers understand the ramifications of 'replacing' a life policy or annuity contract. . . . These insurance contracts are quite complex and certain changes may carry substantial financial consequences . . . ."[2]

AGENT'S/ADVISORS' MOTIVATION:

Financial Advisors/Insurance Agents/ Insurance Producers earn very large commissions for new life insurance sales -- typically at or above 50% of the target/commissionable premium. Commissions on a single sale on large cases are often well over $100,000.00

RISKS AND NEGATIVE CONSEQUENCES:

There are potential Numerous Negative Consequences from twisting including**:**

- Starting a new contestability period
- Surrender charges imposed on the policy being replaced
- New and Higher Surrender charges on the new replacement policy

[1] "Life Insurance Guide" pg. 20, California Department of Insurance, March 2018.

[2] "Press Release 2004-01 New Protections for Life Insurance and Annuity Shoppers", Director Christine Urias, Arizona Department of Insurance, January 5, 2004.

- Being subject to a new suicide clause
- Significant front-end charges
- Higher mortality charges due to increased age

For ***most*** insureds, it would be ***disadvantageous*** to replace existing life insurance. Additional death benefit needs are usually more efficiently accomplished through a) changes to the existing policy and/or b) purchasing additional insurance to cover the additional need.

2. PREMIUM FINANCING

WHAT IT IS:

Borrowing from third party lending institution(s) to pay life insurance policy premiums.

AGENTS'/ADVISOR'S MOTIVATION:

Allows the financial advisor/insurance agent to sell larger policies with significantly higher premiums – sometimes even greater than the insured's annual income. Commissions are typically very large.

SALES PITCH:

Often the sales pitch includes misrepresentations and material omissions, which may include the following:

- "You only have to pay the loan interest"
- After a few years, the policy cash value will pay off the loan balance
- After a handful of years, you will not have to pay any premiums -- the policy will be self-sustaining
- Beginning in year "X", you will receive a tax-free annual income of "Y" dollars

IN REALITY:

It rarely works out the way described in the sales pitch, because:

1) Life insurance policies incur significant expenses, especially in early years, for example:
   a. Underwriting and issue charges
   b. Commissions and overrides
   c. Annual fees
   d. Loads
   e. Mortality charges
   f. Administrative fees

2) Cash value accumulation is heavily weighted against the early years of the policy

a. Often no or very minimal cash value accumulation in early policy years
b. Under best case scenarios, life insurance policies may take 8-10 years for cash values to equal premiums paid (break-even point)

3) Financial advisors/insurance agents may design a policy to maximize commission at the expense of the policy's financial strength

4) Financial advisors/insurance agents may illustrate and base their sales pitch around hypothetical assumptions which are unrealistic and not guaranteed

5) Policies rarely perform as illustrated with hypothetical assumptions

6) Premium finance loan rates are often variable and subject to increase

7) If cash value is accessed to pay the premium finance loan, the policy will incur loan interest charges

3. USING ANNUITIES TO FINANCE LIFE INSURANCE

WHAT IT IS:

Advisor recommends withdrawing money annually from an existing annuity over a certain number of years ("term certain annuitization option") to pay the premium on a ***new life insurance policy***.

AGENT'S/ADVISORS' MOTIVATION:

Financial Advisors/Insurance Agents/ Insurance Producers earn very large commissions for new life insurance sales -- typically at or above 50% of the target/commissionable premium. Commissions on a single sale on large cases are often well over $100,000.00.

This concept often results in the financial advisor/insurance agent selling ***two high commission products*** – an annuity and a life insurance policy.

The life insurance sale is typically larger than what the insured can afford. Premium may even exceed the earned or retirement income of the insured, resulting in significantly larger commissions.

SALES PITCH:

The pitch is that after "X" years, the premium is paid off on the life insurance policy and client can then withdraw income for many years or over a lifetime.

IN REALITY:

It rarely works out that way because:

1) Life insurance policies incur significant expenses, especially in early years, for example:
    a. Underwriting and issue charges
    b. Commissions and overrides
    c. Annual fees
    d. Loads
    e. Mortality charges
    f. Administrative fees
2) Cash value accumulation is heavily weighted against the early years of the policy:

    a. Often no or very minimal cash value accumulation in early policy years
    b. Under best case scenarios, life insurance policies may take 8-10 years for cash values to equal premiums paid (break-even point)

3) Financial advisors/insurance agents, may design a policy to maximize commission at the expense of the policy's financial strength

4) Financial advisors/insurance agents, may illustrate and base their sales pitch around hypothetical assumptions that are unrealistic and that are not guaranteed

5) Policies rarely perform as illustrated with hypothetical assumptions

6) When the annuity term certain period is over, the policy may still require ongoing premium payments to remain in force

7) When the annuity term certain period has ended, the annuitant has exhausted ALL principal from the annuity

8) The client may be left with a policy they don't need or can't afford and may be forced to lapse or surrender at a significant loss

9) If changes occur within the life insurance policy that result in an increase to the overall policy premiums, the policy owner will have to pay the difference in premium amount if the annuity income is not sufficient.

10) Once the Term Certain Annuity option (or any annuitization option) is selected, it cannot be changed or cancelled

Case Illustrations

This illustration is intended to help you understand how your policy works, not to predict or project actual performance. This illustration assumes that the currently illustrated nonguaranteed elements used will not change for all years shown. This is not likely to occur, and actual results may be more or less favorable than those shown. The illustrated investment results are hypothetical. They should not be viewed as representative of past performance nor indicative of future results. Actual investment performance will either be more or less favorable than those shown and will vary depending on the investment allocation(s) chosen. Values vary by the proposed insured's age, sex, risk class, and reflect a variety of illustrated activities, such as planned premiums, coverage amounts, loans, and partial surrenders to illustrate the impact on the policy's performance.

This illustration assumes that all transactions (premium payments, partial surrenders, and/or policy loans and loan repayments) Sub-Account valuation, Indexed Interest Strategy, Fixed Account and Long-Term Fixed Account interest crediting occurs on a policy monthaversary, and that the policy date and all policy monthaversaries occur on a Sweep Date. In reality, transactions can occur on any day, and policy monthaversaries do not occur on Sweep Dates for most policies. All other illustrated values such as death benefits, cash values, cash surrender values and any policy indebtedness are shown as of the end of each policy year.

About the XXXXXXXX VUL Accumulator

VUL Accumulator is an individual permanent life insurance policy designed to provide you with:

- Permanent protection for your family and loved ones
- Flexible premiums
- Income tax-free death proceeds
- Tax-deferred cash value growth potential
- Control over the investment options of the contract
- An investment lineup featuring nationally recognized fund managers and indexed interest strategies
- Access to your money through partial surrenders and loans (certain restrictions apply)

Policy values depend on the timing and amount of your premium payments, the monthly policy deductions, and the investment performance of the selected investment options.

This policy offers a Death Benefit Guarantee Period of 18 years. During this period, there is a no-lapse guarantee based upon your net accumulated premium. As long as the total premium paid, less accumulated partial surrenders and outstanding loan balance, is greater than or equal to the accumulated Death Benefit

Annualized Premium Outlay[3] - Total premium paid into the policy during a policy year.

[3] - You, the applicant, selected the Initial Planned Premium, Lump Sum Premium, and Annualized Premium Outlay shown in this illustration to show how much Premium you intend to pay. Illustrated hypothetical rates of return are not guaranteed. Investment experience varies over time, is rarely the same year-over-year, and may be negative. Because this is a variable insurance product with the potential for unfavorable investment experience, including extended periods of significant stock market decline, you may be required to pay additional Premium in order to meet your goals and/or to prevent the policy from Lapsing. Generally, variable life insurance is considered a long-term investment. Please weigh the investment risk and costs associated with this product against your objectives, time horizon, risk tolerance, and ability to pay additional Premium if necessary.

Attained Age - Issue Age plus the number of full policy years since the policy date.

Cash Value - The amount of premium paid: minus the percent of premium charge ("premium load"), monthly deductions for cost of insurance and other policy and rider charges, and any partial surrenders; plus interest credited and investment experience.

Current Values - The Current Values are based on current policy charges. The illustration assumes that current

Total Loan Balance - Outstanding policy indebtedness plus any unpaid Loan interest.

Policy Charges

A brief description of policy charges is provided below. Please see the prospectus for more detail on policy charges, including any elected optional riders.

Deductions from Premium Payments:

Percent of Premium Charges (including sales charges):

	All Years
Current	6.00%
Guaranteed Max	10.00%

Monthly Deductions - The charges taken from the total cash value, which are the sum of:

- Administrative charge
- Per $1,000 of Specified Amount charge
- Cost of Insurance charge
- Percent of Sub-Account Value charge
- Rider charges

Administrative Charge:

	All Years
Current	$10 / month
Guaranteed Max	$20 / month

Monthly per $1,000 of Specified Amount Charge - Varies by sex, underwriting classification, total Specified Amount, issue age and death benefit option. The Specified Amount in effect at issue and each Specified Amount increase, if any, represent separate segments of coverage under this Policy. Separate monthly per $1,000 of Specified Amount charge rates are used to calculate the monthly per $1,000 of Specified Amount charges for each segment of coverage.

Current	The Current Monthly per $1,000 charge will be assessed for 10 policy years
Guaranteed	The Guarantee Monthly per $1,000 charge will be assessed all policy years

Cost of Insurance Charge - Varies by issue age, length of time the policy is in force, sex, risk class, net amount at risk, and any substandard rating. Current and guaranteed monthly Cost of Insurance Charge rates generally increase year over year to reflect expectations that mortality and underwriting risks generally increase as the Insured's Attained Age and the length of time the Policy has been In Force increase. Please see optional

Surrender Charges

Policy Year	Surrender Charges
1	$506,249.00
2	$506,249.00
3	$506,249.00
4	$442,968.00
5	$379,687.00
6	$316,406.00
7	$253,124.00
8	$189,843.00
9	$126,562.00
10	$63,281.00
11	$0.00

Policy Values - Current Charges / Assumed Rates of Return

	Initial Premium Allocations	Initial Matured Segment Allocations	Initial Assumed Rates of Return
Variable Sub-Accounts	100.00%	N/A	7.00% Gross / 6.35% Net

End of Year	Age	Annualized Premium Outlay(3)	Withdrawal Amount	Loan Amount	Total Loan Balance	Net After-Tax Outlay	Cash Value‡	Cash Surrender Value‡	Net Death Benefit
1	58	3,376,060	0	0	0	3,376,060	3,291,222	2,784,973	15,000,000
2	59	500,000	0	0	0	500,000	3,911,595	3,405,346	15,000,000
3	60	500,000	0	0	0	500,000	4,565,187	4,058,938	15,000,000
4	61	0	0	0	0	0	4,758,106	4,315,138	15,000,000
5	62	0	359,600	0	0	-359,600	4,589,824	4,210,137	14,640,400
Total		**4,376,060**	**359,600**	**0**		**4,016,460**			
6	63	0	359,600	0	0	-359,600	4,408,732	4,092,326	14,280,800
7	64	0	280,800	78,800	79,269	-359,600	4,290,469	3,958,076	13,920,731
8	65	0	0	359,600	449,512	-359,600	4,443,180	3,803,825	13,550,488
9	66	0	0	359,600	834,195	-359,600	4,589,473	3,628,716	13,165,805
10	67	0	0	359,600	1,233,881	-359,600	4,727,954	3,430,792	12,766,119
Total		**4,376,060**	**1,000,000**	**1,157,600**		**2,218,460**			
11	68	0	0	359,600	1,636,315	-359,600	4,930,995	3,294,681	12,363,685
12	69	0 †	0	359,600	2,050,821	-359,600	5,127,030	3,076,209	11,949,179
13	70	0	0	359,600	2,477,763	-359,600	5,314,537	2,836,774	11,522,237
14	71	0	0	359,600	2,917,513	-359,600	5,493,986	2,576,473	11,082,487
15	72	0	0	359,600	3,370,456	-359,600	5,664,485	2,294,029	10,629,544
Total		**4,376,060**	**1,000,000**	**2,955,600**		**420,460**			
16	73	0	0	359,600	3,836,986	-359,600	5,823,145	1,986,159	10,163,014
17	74	0	0	359,600	4,317,513	-359,600	5,967,025	1,649,512	9,682,487
18	75	0	0	359,600	4,812,456	-359,600	6,093,349	1,280,893	9,187,544
19	76	0	0	359,600	5,322,246	-359,600	6,198,940	876,693	8,677,754
20	77	0	0	359,600	5,847,331	-359,600	6,280,577	433,246	8,152,669
Total		**4,376,060**	**1,000,000**	**4,753,600**		**-1,377,540**			
21	78	0	0	299,667	6,328,013	-299,667	6,334,491	6,478	7,671,987
22	79	0	0	0	Lapse	2,220,267	Lapse	Lapse	Lapse
Total		**4,376,060**	**1,000,000**	**5,053,267**		**543,060**			

Target Premium: $402,435.00 7 Pay Premium: $403,153.00 Net Single Premium: $5,852,776.95

Policy Values - Guaranteed Charges / Assumed Rates of Return

	Initial Premium Allocations	Initial Matured Segment Allocations	Initial Assumed Rates of Return
Variable Sub-Accounts	100.00%	N/A	7.00% Gross / 6.35% Net

End of Year	Age	Annualized Premium Outlay(3)	Withdrawal Amount	Loan Amount	Total Loan Balance	Net After-Tax Outlay	Cash Value‡	Cash Surrender Value‡	Net Death Benefit
1	58	3,376,060	0	0	0	3,376,060	2,982,351	2,476,102	15,000,000
2	59	500,000	0	0	0	500,000	3,394,752	2,888,503	15,000,000
3	60	500,000	0	0	0	500,000	3,826,326	3,320,077	15,000,000
4	61	0	0	0	0	0	3,797,093	3,354,125	15,000,000
5	62	0	359,600	0	0	-359,600	3,383,048	3,003,361	14,640,100
Total		**4,376,060**	**359,600**	**0**		**4,016,460**			
6	63	0	359,600	0	0	-359,600	2,929,965	2,613,559	14,280,200
7	64	0	280,800	78,800	79,269	-359,600	2,512,287	2,179,894	13,919,881
8	65	0	0	359,600	449,512	-359,600	2,335,356	1,696,000	13,549,638
9	66	0	0	359,600	834,195	-359,600	2,116,363	1,155,606	13,164,955
10	67	0	0	359,600	1,233,881	-359,600	1,850,798	553,635	12,765,269
Total		**4,376,060**	**1,000,000**	**1,157,600**		**2,218,460**			
11	68	0	0	359,600	Lapse	-359,600	Lapse	Lapse	Lapse
Total		**4,376,060**	**1,000,000**	**1,517,200**		**1,858,860**			

Applicant

I certify that I have received a copy of this illustration from the producer along with a current prospectus. I also understand that this illustration is not a contract and that the terms of the policy constitute the actual agreement of coverage.

I understand that I selected the Premium shown in the illustration to show xxxxxxxx how much Premium I intend to pay. Illustrated hypothetical rates of return, referred to as Alternate Rates of Return, may not be guaranteed. Investment Experience varies over time, is rarely the same year-over-year, and may be negative. I understand that this is a variable insurance product with the potential for unfavorable investment experience in any selected Variable Sub-Accounts, including extended periods of significant stock market decline. In the event of any unfavorable investment experience, I understand that I may be required to pay additional Premium in order to meet my goals and/or to prevent the policy from lapsing.

I understand that illustrated non-guaranteed policy charges are subject to change and could be higher. In the event illustrated non-guaranteed policy charges are higher, I understand that I may be required to pay additional Premium in order to meet my goals and/or to prevent the policy from lapsing.

Policy was not illustrated as a Modified Endowment Contract.

Applicant **Date**

APPLICABLE LAWS / REGULATIONS

I. REGULATORY JURISDICTION OVER PRODUCTS

TRADITIONAL LIFE INSURANCE POLICIES

Traditional life insurance policies are regulated by state insurance departments.

FIXED ANNUITIES

Fixed annuities are regulated by state insurance departments.

VARIABLE LIFE INSURANCE POLICIES

Life insurance policies with variable sub-accounts, such as variable life, flexible premium variable life, and variable universal life, are regulated by FINRA and state insurance departments.

II. FINRA RULES/GUIDANCE GENERALLY

FINRA RULE 2111. SUITABILITY

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

FINRA Rule 2210 – COMMUNICATIONS WITH THE PUBLIC

Rule 2210(d)(1)(D): General Standards – "Members must ensure that statements are clear and not misleading within the context in which they are made, and that they provide balanced treatment of risks and potential benefits. Communications must be consistent with the risks of fluctuating prices and the uncertainty of dividends, rates of return and yield inherent to investments."

Rule 2210(d)(1)(E): General Standards – "Members must consider the nature of the audience to which the communication will be directed and must provide details and explanations appropriate to the audience."

Rule 2210(d)(2): Comparisons – "Any comparison in retail communications between investments or services must disclose all material differences between them, including (as applicable)

investment objectives, costs and expenses, liquidity, safety, guarantees or insurance, fluctuation of principal or return, and tax features."

REGULATORY NOTICE 12-03. HEIGHTENED SUPERVISION OF COMPLEX PRODUCTS

The registered representative who intends to recommend a complex product should discuss with the retail customer the features of the product, how it is expected to perform under different market conditions, the risks and the possible benefits, and the costs of the product. The registered representative also should discuss the scenarios in which the product may perform poorly. The registered representative should do so in a manner reasonably likely to facilitate the customer's understanding. The registered representative should consider whether, after this discussion, the retail customer seems to understand the basic features of the product, such as the fundamental payout structure and the nature of underlying collateral or a reference index or asset.

https://www.finra.org/rules-guidance/notices/12-03

III. FINRA RULES/GUIDANCE ON REGARDING SENIOR INVESTORS

GUIDANCE ON SENIOR INVESTORS

"[A] firm's procedures and controls should take into consideration the age and life stage (whether pre-retired, semi-retired or retired) of their customers. Of particular concern to FINRA is the suitability of recommendations to senior investors, communications targeting older investors, and potentially abusive or unscrupulous sales practices or fraudulent activities targeting senior investors."
https://www.finra.org/rules-guidance/key-topics/senior-investors

FINRA RULE 4512 (CUSTOMER ACCOUNT INFORMATION)

"[R]equires members to make reasonable efforts to obtain the name of and contact information for a trusted contact person upon the opening of a non-institutional customer's account or when updating account information for a non-institutional account. The trusted contact person is intended to be a resource for the member in administering the customer's account, protecting assets and responding to possible financial exploitation." https://www.finra.org/rules-guidance/rulebooks/finra-rules/4512

FINRA RULE 2165 (FINANCIAL EXPLOITATION OF SPECIFIED ADULTS)

"[P]ermits, under FINRA rules, a member that reasonably believes that financial exploitation has occurred, is occurring, has been attempted or will be attempted to place a temporary hold on the disbursement of funds or securities from the account of a "specified adult" customer. Specified adults include a natural person age 65 and older or a natural person age 18 and older who the member reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests." https://www.finra.org/rules-guidance/rulebooks/finra-rules/2165

FINRA REGULATORY NOTICE 07-43 (FINRA REMINDS FIRMS OF THEIR OBLIGATIONS RELATING TO SENIOR INVESTORS AND HIGHLIGHTS INDUSTRY PRACTICES TO SERVE THESE CUSTOMERS)

"FINRA does not have special rules for senior customers. [Enacted 2165 and 4512 changes after this notice, which include some special rules for seniors] Firms owe all their customers the same obligations and duties. However, in executing those duties, age and life stage (whether pre-retired, semi-retired or retired) can be important factors, and firms should make sure that the procedures they have in place take these considerations into account where appropriate. Two areas of particular concern to FINRA are the suitability of recommendations to, and communications aimed at, older investors."

"[R]egulators found troubling sales practices, including the use of false or misleading sales materials used in connection with high-pressure sales seminars aimed exclusively or primarily at seniors or those at or nearing retirement. Among the most common practices were inaccurate or exaggerated claims regarding the safety, liquidity or expected returns of the investment or strategy being touted; scare tactics; misrepresentations or material omissions about the product or strategy; conflicts of interest; or misleading credentials used by persons sponsoring or participating in the seminar."

https://www.finra.org/rules-guidance/notices/07-43

IV. FINRA RULES RE VARIABLE LIFE / VARIABLE ANNUITIES

FINRA Rule 2211 - Communications with the Public About Variable Life Insurance and Variable Annuities

Rule 2211(b)(5)(C): Hypothetical Illustrations of Rates of Return in Variable Life Insurance Retail Communications and Correspondence: “In general, it is inappropriate to compare a variable life insurance policy with another product based on hypothetical performance as this type of presentation goes beyond the singular purpose of illustrating how the performance of the underlying investment accounts could affect the policy cash value and death benefit.”

V. MODEL REGULATION RE LIFE INSURANCE AND ANNUITIES

Model Rule 613 - LIFE INSURANCE AND ANNUITIES REPLACEMENT MODEL REGULATION (https://www.naic.org/store/free/MDL-613.pdf):

Table of Contents:
Section 1. Purpose and Scope
Section 2. Definitions
Section 3.Duties of Producers
Section 4. Duties of Insurers that Use Producers
Section 5. Duties of Replacing Insurers that Use Producers
Section 6. Duties of the Existing Insurer
Section 7. Duties of Insurers with Respect to Direct Response Solicitations
Section 8. Violations and Penalties

Section 9. Severability
Section 10. Effective Date
Appendix A. Important Notice Regarding Replacements
Appendix B. Notice Regarding Replacements for Direct Response Insurers
Appendix C. Important Notice Regarding Replacements for Direct Response Insurer

"A. The purpose of this regulation is:

(1) To regulate the activities of insurers and producers with respect to the replacement of existing life insurance and annuities.

(2) To protect the interests of life insurance and annuity purchasers by establishing minimum standards of conduct to be observed in replacement or financed purchase transactions. It will:

(a) Assure that purchasers receive information with which a decision can be made in his or her own best interest;

(b) Reduce the opportunity for misrepresentation and incomplete disclosure; and

(c) Establish penalties for failure to comply with requirements of this regulation."

Disclaimer

The sales practices discussed included examples of financial advisors manipulating concepts and the sale of financial products to maximize commission income to the detriment of their client.

There are specific circumstances in which the products and concepts discussed may be an appropriate solution.

Determination as to the suitability of specific recommendations requires a thorough review of the client's profile and detail regarding the recommendations at the time of the recommendation.

GETTING THE GOOD STUFF THROUGH LIST 1 OF THE DISCOVERY GUIDE

Michael S. Edmiston[1]

List 1 of the FINRA Discovery Guide makes numerous documents in the possession, custody, and/or control of a broker-dealer presumptively discoverable.[2] A full production of the List 1 documents would likely achieve the goal of fast and efficient dispute resolution.[3] The idealism of arbitration rarely fares well in reality, and in discovery, idealism is still looking for its home. The reason is there is no incentive for Respondents to produce the "Good Stuff" until Claimant's counsel applies sufficient pressure to do so.

The Good Stuff rarely appears in Respondents' first production. Instead, the initial production usually consists of account statements, trade confirmations, correspondence and e-mails between the firm and/or broker and Claimant, the occasional prospectus or private placement memorandum, and rarely some exception reports related to Claimant's account or investment(s). Missing are all the internal documents, communications, and documents related to the securities, products, broker, and firm. From a defense philosophy, the initial production accomplishes the defense's goal: make the case about the Claimant.

List 1's "Good Stuff" are the documents and information that focus the case on the broker, firm and product. They are the documents that put Respondents' actions and inactions at issue and make their counsel play defense rather than attack the customer-Claimant.

Obtaining production of missing documents is a critical, if numbingly repetitive, exercise in a customer case. The documents are withheld behind walls of obfuscating responses, objections, claims of privilege, and tricky unilateral limitations of promises to produce selections of responsive documents. Getting the Good Stuff requires knowing what documents exist or should exist, and then whittling through the obfuscations and objections, and the generous sounding, but functionally useless, promises to produce the Claimant-related selections of responsive documents.

The Discovery Guide and FINRA Code of Arbitration Procedure provide the tools to get those documents. This article will discuss several Items from List 1 of the FINRA Discovery Guide and the categories of documents which often exist but firms do not want to produce; addressing the objections and claims of privilege; the use of affirmations of search; and meet and confer tactics.

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[1] Laura S. Dunning and Moshe Y. Singer contributed greatly to this article and are both deserving of a "Thank You" for helping us all get the Good Stuff.

[2] FINRA, Regulatory Notice 11-17, updated December 2, 2013, https://www.finra.org/sites/default/files/ArbMed/p394527.pdf (last visited Aug. 8, 2020). Hereinafter referred to as "Discovery Guide."

[3] FINRA states arbitration is "faster, cheaper and less complex than litigation." https://www.finra.org/arbitration-mediation/overview (last visited Aug. 8, 2020).

I. THE DISCOVERY GUIDE'S GOOD STUFF RESPONDENTS DON'T WANT YOU TO HAVE

List 1, Item 5(a) – Due Diligence, Research, and Testing Data

Item 5(a) requires production of "All materials the firm and/or associated persons prepared or used and/or provided to the customer parties relating to the transactions or products at issue, including research reports, sales materials, performance or risk data, prospectuses, other offering documents, and copies of news articles or outside research, including documents intended or identified as being 'for internal use only.'"

The Respondents' usual tactic is to promise to produce the responsive documents *provided to the Claimant*. The key phrase Respondents want to avoid is "[a]ll materials the firm and/or associated persons prepared or used…" There is no limitation in this Item to just documents provided to the Claimant. Item 5(a) opens the door to due diligence documents, third-party due diligence, internal and external research sources, and performance testing. Generally, these are documents not given to a customer. In product cases, Item 5 holds the key to what the firm knew about the product, its risks, and its problems.

List 1, Item 7(a) – Supervisory Notes and Memoranda About the Broker

Item 7(a) requires production of the documents showing what the firm's supervisors knew about both the customer and the broker. Specifically, it requires production of all notes or memoranda evidencing supervisory, compliance, or managerial review of:

1) the customer parties' accounts or transactions therein or

2) of the associated persons assigned to the customer parties' accounts for the period at issue.

The Respondents' typical tactic is to promise production of only the documents indicating supervisory review of the customer's account.

While sometimes the Claimant-specific documents are helpful, what is being excluded is the information the firm had about the broker. Heightened supervision documents, accumulated risk scores for multiple exception reports, internal e-mails about the broker's activities and practices, and outside business activities are all documents Respondents do not want revealed. Even better, the documents should show some marks or indications of supervisory review. For a failure to supervise case, Item 7(a) is a treasure trove of documents showing what the firm knew about its broker.

List 1, Item 9 – Communications with the Compliance Department

Item 9 requires production of internal communications between the broker and his/her compliance department about the customer (claims, accounts, and/or transactions) and/or the securities/products at issue. Respondents often unilaterally limit the scope of this request to e-mail communications to/from the broker about the Claimant and Claimant's account(s).

Item 9 is a gift in product cases because it opens the door to every communication between the broker and the "compliance department" about the securities /product(s) at issue. There is no limitation on the recipient of communication. Further, Item 9 is very helpful for claims involving alternative investments, structured products, and other securities which often receive additional regulatory attention. Communications about compliance issues regarding the same type of security (e.g., non-traded REITs, private placements or reverse convertible notes) can be very

valuable for most customer claims, particularly when such communications highlight changes to supervisory and compliance manuals.

List 1, Item 13(b) – Broker-Specific Exception Reports

Item 13(b) cuts to the heart of what the firm knew about its broker's day-to-day sales activities. The documents required to be produced are "…all exception reports, supervisory activity reviews, concentration reports, active account runs, and similar documents produced to review for activity in customer accounts handled by associated persons and related to the allegations in the Statement of Claim that were generated not earlier than one year before or not later than one year after the transactions at issue."

13(b) is often met with outright objections (e.g., relevancy, burden, and privacy) and Respondents frequently unilaterally try to limit the scope of documents to just those documents related to Claimant and Claimant's account(s). The proposed compromise is a rehash of what is already presumptively discoverable under Item 13(a).

Along with revealing a broker's patterns and practices which rub against the firm's supervisory and compliance risk limitations, the documents often contain the names of supervisors and compliance personnel, the frequency which a given supervisor sees and/or responds to an exception report, notes and comments about the response, and sometimes "scores" which are weighted by the type of conduct, the frequency with which it occurs, and set time period used to measure the frequency (e.g., six months or one year). The information contained in 13(b) is the reason to pursue discovery early as it may be necessary to propound additional discovery requests based on the information learned in the 13(b) documents. 13(b) is also the most likely Item that Respondents will force to a motion to compel because the materials are so very rich.

List 1, Item 14 – Branch Audit Reports

Item 14 requires production of "[t]hose portions of internal audit reports for the branch in which the customer parties maintained accounts that: (a) concern associated persons or the accounts or transactions at issue…" Respondents often will seek to limit the scope of the Item with the promise to produce audit reports which mention Claimant or Claimant's accounts. Once again, Respondents do not want to produce the internal documents which memorialized the audit of the broker assigned to the Claimant.

Like 13(b), Item 14 can be a jackpot of internal information about the broker's practices coupled with written conclusions by the auditor. Unlike 13(b), the audits may only look at a select few of the broker's accounts in an annual inspection.

Item 14 is particularly valuable in cases against independent broker-dealers with their numerous remote one- and two-person offices. The scheduled annual visit from a compliance officer is often an exercise in how well the auditor checks the boxes on a lengthy checklist and how well the broker, usually having seen a copy of the checklist, has prepared the office to give the "right" answers. An unscheduled audit or follow-up audit is often more revealing about the broker's practices and procedures in independent firms.

Behind the audits are almost always internal e-mails from the auditor to the firm's management about the audit results as well as e-mails exchanged between the broker, supervisor and/or auditor addressing discrepancies found as a result of the audit.

List 1, Item 15 – Disciplinary Actions Against Broker

Item 15 requires production of "[r]ecords of disciplinary actions taken against associated persons by any regulator… or employer for all sales practice violations or conduct similar to the conduct alleged in the Statement of Claim."

The Respondents will likely offer to produce those disciplinary actions in which the Claimant or Claimant's accounts were involved. This unilateral limitation makes Item 15 almost useless except for the rare situation where FINRA has already brought an enforcement action based on what occurred to the Claimant.

There is a second angle of pedanticism available to Respondents responding to this Item, the phrase, "all sales practice violations or conduct similar to the conduct alleged in the Statement of Claim." "Conduct similar" is not defined in the Discovery Guide.

Item 15 documents can be particularly valuable when their date of creation is earlier than the alleged wrongful conduct in the Statement of Claim. A suspension, heightened supervision, or even cautionary memorandum gives evidence of the firm's supervisors possessing first-hand awareness of the broker's issues. Coupled with Item 13(b) exception reports and Item 14 audit reports, the firm's supervision system and it's reasonableness, or lack thereof, in implementation or execution becomes much easier to establish.

Item 15 requires some thoughtful consideration to avoid being trapped by a narrow definition of "conduct similar" and an earmark on the response to save for a meet and confer discussion.

List 1, Item 16 – Regulatory investigations, charges, or findings and Responses Thereto

Item 16 is a valuable source of documents not just for the investigation but for the responses by the firm and/or broker produced to the regulator. The FINRA (or other regulatory agency) investigation generally seeks production of documents such as the trade blotters and exception reports. These are same documents Respondents do not want to produce in the arbitration, but are routinely produced to regulators.

Once organized and having been previously produced, there is little burden beyond redaction of non-party information for Respondents to make the same production in the arbitration. As a result, Respondents' effort to keep the documents out of the arbitration falls to the standby of limiting the production to Claimant and Claimant's account, and then usually claiming some sort of "regulatory privilege."

There is no "regulatory privilege" prohibiting production of the responsive documents, and the only privilege that does exist belongs to the regulator itself for its investigative files. FINRA particularly does not promise and will not agree to keep the documents submitted to it in a confidential form.[4]

Like Item 15, this Item puts a nexus on the documents, where all that needs to be produced are the documents for "…the associated persons' alleged improper behavior similar to that alleged in the Statement of Claim."

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[4] ORDER at 3, *Bussing v. COR CLEARING, LLC, et al.*, No. 8:12CV238, (D. Nebraska Oct. 16, 2015). Available at https://www.govinfo.gov/content/pkg/USCOURTS-ned-8_12-cv-00238/pdf/USCOURTS-ned-8_12-cv-00238-18.pdf (last visited Aug. 14, 2020).

Recently, Respondents' counsel have been asserting a new "objection" or interpretation that they will only produce the types of "investigations" and "charges" as defined in the Form U-4 Explanation of Terms. The Form U-4 Explanation of Terms[5] defines an "Investigation" as:

> (a) grand jury investigations; (b) U.S. Securities and Exchange Commission investigations after the "Wells" notice has been given; (c) FINRA. investigations after the "Wells" notice has been given or after a person associated with a member, as defined by The FINRA By-Laws, has been advised by the staff that it intends to recommend formal disciplinary action; (d) NYSE Regulation investigations after the "Wells" notice has been given or after a person over whom NYSE Regulation has jurisdiction, as defined in the applicable rules, has been advised by NYSE Regulation that it intends to recommend formal disciplinary action; (e) formal investigations by other SROs; or (f) actions or procedures designated as investigations by jurisdictions. The term investigation does not include subpoenas, preliminary or routine regulatory inquiries or requests for information, deficiency letters, "blue sheet" requests or other trading questionnaires, or examinations.

The most problematic part of the U-4 definition of "investigations" is the final sentence, "The term investigation does not include subpoenas, preliminary or routine regulatory inquiries or requests for information, deficiency letters, 'blue sheet' requests or other trading questionnaires, or examinations." Most FINRA investigations start with a regulatory inquiry, 8210 letter requesting documents, or more modernly, a FINRA "Gateway Request"[6] for documents. If left unaddressed, the definition removes everything but the most severe and rare regulatory investigations from the scope of discoverable documents.

The FINRA Discovery Guide does not define the terms "investigations" or "charges." Thus, there is no incorporation or reference to Respondents' narrow definition. Addressing the Form U-4 definition it is important to remember the disclosures required to be made to a regulator are more narrowly construed than the standard for discoverable documents.

List 1, Item 17 – Examination Reports

Item 17 considers regulatory examination reports that focused on the associated persons or the customer parties' claims, accounts or transactions, or the product or types of products at issue or that discussed alleged improper behavior in the branch against other individuals similar to the conduct alleged in the Statement of Claim to be discoverable. Once again, the usual response from Respondents is to agree to produce those examination reports which mention Claimant and/or Claimant's account.

It is the rare case in which a Claimant or a Claimant's account is mentioned in an examination report. However, with FINRA, the SEC, and state regulators all conducting various routine exams and "for cause" exams, the probability of an examination report existing is much greater.

The examination reports often identify not only the problematic conduct but also may reveal in-the-moment or post-examination responses from the firm about the conduct and efforts to mitigate or remedy it.

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[5] https://www.finra.org/sites/default/files/AppSupportDoc/p468051.pdf (last visited August 6, 2020).

[6] https://www.finra.org/filing-reporting/finra-gateway (last visited August 6, 2020).

List 1, Item 19 – Broker's Compensation for Client's Accounts

Item 19 is designed to answer how much the broker made from the Claimant's transactions. Sometimes the answer is simple, a single commission for a single product. Other times, hundreds or thousands of trades are at issue, creating a challenging situation to total up the commissions.

It is important to look at each account at issue and determine whether it is a commission-based or fee-based account. Not only is the compensation different, but the duties owed by the broker or investment adviser representative are different as are the defenses.

Item 19 is also an opportunity to test whether Respondents will try to avoid producing documents in reasonably usable format (e.g., an excel spreadsheet).

List 1, Item 20 – Broker's Overall Compensation (Trade Blotter)

Item 20(a) is one of the most powerful documents counsel can obtain through discovery. It is the broker's complete commission run and contains much of the data required to be reported in the broker's trade blotter. It shows what the broker was soliciting, the dates, quantities, compensation, and a minimal detail of account numbers to sort the data but not reveal non-party private data.[7]

Item 20(a) almost always meets with a litany of objections and a promise to produce the commissions related to Claimant's accounts (duplicative of List 1, Item 19's scope).

The underlying reason for the objections is that Respondents do not want the broker's patterns and practices revealed. Once introduced, the data in Item 20 can shift the case from the narrow, cornered, customer-specific analysis to an inquiry focused on the basis of the broker's recommendation and pattern of recommendations.

The second level of Item 20(a) is getting the data produced in reasonably usable format, an Excel spreadsheet. If the data is produced in pdf format, it will likely be two or three pages wide and likely hundreds of pages long. A pdf production denies two benefits of the document: 1) performing mathematical calculations; and 2) sorting the data.

The ability to use Excel's formula functions allows for efficient and accurate computation of the amount of commissions earned by the broker.

The ability to sort the data by multiple levels, for example, by security name and then by date of transaction, can reveal when a broker grew hot or cold on a security, as well as the commissions earned. A sort by net commissions can reveal higher paying products and even a pattern of certain accounts generating larger commissions. Sorting by product and whether the trades were solicited or unsolicited often contradicts the defense of "the client wanted it" when a large portion of the same broker's clients "wanted" the same obscure product. Sorting by product and commission often defangs the "market-went-down" defense when the broker's commissions reveal the true basis for the recommendations.

Like 13(b), Item 20(a) is so data-rich that Respondents may be unwilling to produce it under any circumstances without an order from the Panel.

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[7] See, MICHAEL S. EDMISTON, *Investors, Cornered*, 22 PIABA BJ 337 (2015).

List 1, Item 21 – Compensation Plan

Item 21 requires production of "record[s] of all agreements pertaining to the relationship between the associated persons and the firm, summarizing the associated persons' compensation arrangement or plan with the firm."

Often the Respondents will offer to produce the "grid" or compensation schedule for the broker showing the split between the firm and broker on commissions.

Obtaining the complete employment (and/or independent contractor) agreement can be very useful for the case. The Agreement often identifies requirements to carry errors and omission insurance and whether the broker must indemnify the firm for losses as a result of customer complaints and arbitration claims, and even production goals or references thereto.

Another important compensation agreement are bonuses paid in the form of forgivable loans. Most commonly seen in recruiting scenarios, the bonuses put immediate pressure on the broker to start producing in order to avoid having to repay the loan. Marrying up the dates of the forgivable loans and trade blotter (Item 20) often will show increased production soon after the loans were funded.

II. MEET AND CONFER TACTICS – GET THE GOOD STUFF WITHOUT A MOTION

FINRA Code of Arbitration Procedure Rule 12503(a)(1) requires counsel to meet and confer prior to filing a motion. Based on the initial production of documents and litany of objections, unilateral limitations, and promises to produce only slices of the Discovery Guide, a meet and confer effort is necessary in virtually every case.

Embrace the meet and confer requirement. A thorough and well-written meet and confer letter will serve as the guide to a meet and confer telephone conference and will become Exhibit A to any Motion to Compel. The letter will also serve as a checklist to determine which issues have been resolved and which remain outstanding. As an added bonus, a detailed meet and confer letter will meet with the requirement of Rule 12505, which holds "…parties must cooperate to the fullest extent practicable in the exchange of documents and information to expedite the arbitration.[8]

A. CUT THROUGH THE GENERAL OBJECTIONS AND ITEM SPECIFIC OBJECTIONS

FINRA Code of Arbitration Procedure Rule 12508(a) sets the standards for making objections to the Discovery Guide List Items and other discovery requests. "If a party objects to producing any document described in Document Production Lists 1 or 2 or any document or information requested under Rule 12507, it must specifically identify which document or requested information it is objecting to and why." Rule 12508(a) goes on to state the consequence of not being specific in the objection: "Parties must produce all applicable listed documents or other requested documents or information not specified in the objection…"

Respondents' general objections never meet the Rule 12507 standard since they are not specific to any List Item and do not identify which document or information is being objected to and why. Similarly, Respondents rarely identify or describe the documents they are objecting to producing

[8] See, *Creative Counters to Dirty Deeds – Using Respondents' Dirty Tricks To Your Advantage,* PIABA 26th Annual Meeting*,* Closed Session Written Materials (2017)*.*

for each List Item. Rule 12508(a) gives the remedy for sweeping and lazy objections: mandatory production. Strategically, Respondents usually wait until the last day of the deadline to file their responses (or last day of an extended deadline). As a result, Rule 12508(b) holds that any objection not made within the required time is waived absent a Panel finds substantial justification for the failure to make the objection. When Respondents serve their responses, they serve a gift to Claimant's counsel, they have cut off their ability to amend their objections.

In the meet and confer letter, along with identifying Rule 12508 setting forth the standard for objections, ask Respondents' counsel to describe each document withheld for each General Objection. Rule 12505 requires a good faith compliance with discovery, there is nothing wrong with asking Respondents to comply with their good faith obligation.

B. PROMISES TO PRODUCE SELECTIONS OF NON-PRIVILEGED DOCUMENTS

Respondents usually promise to produce only the "non-privileged" responsive documents and only those related to Claimant. A claim of privilege, like an objection is governed by Rule 12508(a). If the privilege is not identified and the document not described, the remedy is production of the document.

Respondents' claims of privilege are usually the non-existent self-critical analysis privilege,[9] a Graham-Leach-Bliley Act[10] privacy privilege, or a regulatory investigative privilege.[11] Often pointing out the non-existence of these non-privileges is sufficient to put paid to the issue.

There is always one mutually assured destruction issue, attorney-client privileged documents. While a run can be made at Respondents not providing a privilege log of such documents, the reverse can be done to Claimant. Strategically, it may be worth clarifying or excluding claims of attorney-client privilege to avoid the laborious creation and exchange of privilege logs.

C. AFFIRMATIONS OF SEARCH

In 2013, when FINRA revised the Discovery Guide, it changed the rules for affirmations of search. Under the old Discovery Guide, the standard for obtaining an affirmation of search required no documents be produced. The new rule holds:

> If a party does not produce a document specified in a List item on the applicable Document Production List, upon the request of the party seeking the document that was not produced, the customer or the appropriate person in the brokerage firm who has knowledge, must: 1) affirm in writing that the party conducted a good faith search for the requested document; 2) describe the extent of the search

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[9] E.g., *Uniformed Fire Officers Ass'n v. City of New York*, 955 N.Y.S.2d 5 (1st Dept. 2012) ("[T]his privilege has never been recognized under New York law…"); and *Lamitie v. Emerson Elec. Co.*, 142 A.D.2d 293, 299, 535 N.Y.S.2d 650 (3rd Dept. 1988).

[10] 15 U.S.C § 6801. Gramm-Leach-Bliley Act, 15 U.S.C. sec. 6801 et seq. focuses on protecting client data from sale or other unrelated commercial use by a financial institution. Subsection (e)(5) of Section 6802 specifically allows disclosure of private customer information to "self-regulatory organizations" such as FINRA, and Subsection (e)(8) of Section 6802 specifically permits disclosure of private customer information in response to subpoenas and other judicial process.

[11] PHILIP M. AIDIKOFF ET AL., *Discovery of Regulatory Documents: Debunking the Myth of an "Sec Privilege" in Securities Arbitration* 18 PIABA BJ 187 (2011); *Kirkland v. Superior Court (Guess? Inc.)*, 115 Cal. Rptr. 2d 279 (Ct. App. 2002) holding that investigatory documents and responses thereto are business records and are neither privileged nor confidential.

> including, but not limited to, stating the sources searched; and 3) state that, based on the search, the party does not have the requested document in the party's possession, custody, or control.[12]

Respondents' lazy discovery responses are once again a gift. They tell you which documents they are not producing. For example, Item 13(b)'s objections and claims of privilege create a fair assumption that there are responsive documents that have not been produced. If there are no responsive documents, why was it necessary to object? If Respondents will not drop the nonsensical objections and claims of privilege, ask for the affirmation of search. There is no requirement in the affirmation that it be limited to non-privileged documents At a minimum it will reveal the existence of the documents and provide a description of the documents being withheld, and if there truly are not responsive documents, someone in the Respondent's firm will lock the firm into a signed statement no documents were found and they do not have the documents.

Some Respondents try to have their counsel or an employee in the General Counsel's office execute the affirmation of search rather than the person who "has knowledge" or actually conducted the search. Read that affirmation carefully and seek the signature(s) of the firm-level staff or officers who actually conducted the search.

D. THE E-MAIL AND ELECTRONIC RECORDS SEARCH

Respondents' initial e-mail production is usually limited to the e-mails exchanged between the broker and Claimant. Those e-mails, while responsive to parts of various List Items, are an incomplete universe of the documents. Firms may use electronic communication software beyond just e-mail, and there are certainly other employees of the firm ("repositories") who have sent or received e-mails related to the Claimant, the accounts, product, or broker. Identifying the repositories can be a challenge, the obvious ones are the broker, the broker's supervisor, the broker's assistant(s), and the "compliance department." Less obvious repositories may be due diligence committee members, human resources, Anti-Money Laundering personnel, research personnel, and other firm-specific departments identified in the manuals. Creating a chart of each repository, job title, and relation to the case (e.g., name appears in a previously produced document) helps to explain to Respondents why a search of that given person's e-mail account is reasonable for the purposes of discovery.

Identifying the search terms can be difficult. Start with the easy terms, Claimants' names and account numbers. From there, expand to product names, CUSIPS, customer numbers, family members' names, FINRA investigation file numbers, and terms found in the prior discovery production(s). This may also be a chance to review the firm and broker's Brokercheck and CRD reports to look for outside business activities, other customers' complaints and claims, and settlement contributions. It may also be an opportunity to search the filings with the SEC and state securities regulators for more terms.

The problem with search terms often becomes one of scope. Asking for all e-mails from all repositories which mention "AAPL" will be so broad to be objectionable, add a significant redaction burden to the firm, and even if produced, the documents would be overwhelming in their irrelevancy. Go back to Rule 12505 and make a good faith and thoughtful request for search terms, and use Boolean connectors to limit the probability of false positives.

[12] Discovery Guide at p. 5.

Also be clear on what is to be searched, the subject lines, e-mail text, and attachments. Some firms will try to keep the Good Stuff in attachments to e-mails.[13]

Well prepared search terms and reasonable identification of repositories communicate Claimant's counsel's knowledge of the case, shows respect and reasonableness for the discovery process, force Respondents' counsel to consider the issue from Claimant's standpoint, gets Respondents' decision-makers involved in deciding whether to retain an outside vendor to conduct discovery, and often gets an insurance carrier involved in looking at the costs of the defense.

E. THE INDIVIDUAL LIST ITEMS

For each List Item in dispute, identify the List Item, and ask a few questions (or make a few requests):

A. Please identify all documents responsive to this List Item which are being withheld by a claim of privilege, and the specific privilege claimed for each document withheld.

B. Please identify all documents responsive to this List Item which are being withheld by an objection asserted in response to this List Item and the specific objection claimed for each document being withheld.

C. Please confirm Respondents have finished their search for documents responsive to this List Item.

D. Please confirm all documents other than those being withheld by a claim of privilege or objection have been produced.

E. Please provide the affirmation of search for this List Item.

Depending on the List Item two additional instructions may be helpful:

F. Claimant consents to the redaction of all PCI of non-parties contained in the documents responsive to this List Item. Claimants request that only the last four digits of any account number, contract number, or policy number associated with any brokerage account, investment or insurance product be left intact.

G. For all spreadsheets produced responsive to this List Item, please produce the spreadsheet in Excel format with full functionality enabled.

The alphabetized checklist of requests will efficiently narrow the issue, and make it very easy to track any agreements to produce documents or provide additional information.

F. A GAME OF TELEPHONIC CAT-AND-MOUSE

A well-written meet and confer letter may knock loose a supplemental production, mainly of documents that were not ready to be produced at the time of the initial production. The Good Stuff still will not be produced.

[13] On November 17, 2016, FINRA sanctioned Oppenheimer & Co., Inc. for failing to produce discoverable spreadsheets contained in e-mail attachments in response to discovery requests propounded in seven arbitration claims. FINRA Acceptance, Waiver & Consent, Case No. 2015046355401 (November 17, 2016).

A well-written meet and confer letter will usually result in a nicely written letter explaining why Respondents are objecting (without actually identifying any documents) and a polite suggestion to have a call to meet and confer. Translated and summarized, the response letter reads: "Please go commit a physiologically improbable act, but maybe call me first."

The meet and confer call is where all the work a detailed meet and confer letter will get some or all of the Good Stuff produced. It also requires good note taking.

1. General Objections and Claims of Privilege

For the General Objections, ask outright whether documents are being withheld pursuant to any General Objection. If the answer is "no," it is usually qualified with a statement that the Item-specific objections control. Make a note for the memorialization.

For the claims of privilege, ask whether documents are being withheld on a claim of privilege other than attorney-client. The answer is usually, "no." If "yes," ask for counsel to identify the List Item, describe the document, and the specific privilege claimed. Other than attorney-client, the claims of privilege will normally evaporate. Make a note for the memorialization. If a claim of privilege is still asserted chase it down to a specific privilege and document description.

2. Affirmations of Search

For affirmations of search, ask for them. The very worst response to receive is "Respondents will not provide affirmations." Make a note. Depending on the response, level of trust with Respondents' counsel, and the case, it may not be necessary to pursue affirmations of search for each List Item. If that is the case, the use of affirmations of search may become a negotiation tool.

3. The Individual Requests

Getting the documents from the individual List Items will take the majority of time.

The Cat and Mouse game involves using the five to seven questions/requests for each part of the meet and confer letter.

The initial step is to learn whether responsive documents exist. A blunt but polite question based on the specific List Item such as, "are there internal discipline documents for the broker" (Item 15) is not out of line. The usual response from Respondents' counsel is "I don't know." The follow up is to ask Respondents counsel to confirm whether there are any responsive documents at all, and then offer to have a discussion if such documents exist. For the Items which have a "conduct similar" qualifier, ask if documents are being withheld subject to the interpretation of "conduct similar."

Once the documents are confirmed to exist, the discussion often becomes easier as Respondents' counsel generally wants to avoid a motion on the Item. Quite often with the existence of the document known and no reasonable basis for an objection, it will be produced. If Respondents still want to fight the issue, enough groundwork has been made to show the document exists, and if necessary, its relation to "conduct similar" to succeed on a motion to compel.

Of course, if the Respondents' response is no such documents exist, consider asking for the affirmation of search.

When Respondents' counsel refuses to waive the Item specific objections, will not admit to the existence of the documents, and says words to the effect, "you will need to get an order from the panel for Respondents to produce those documents," there is one last step. Ask Respondents' counsel "to confirm whether there are actually responsive documents being withheld in order to avoid unnecessary motion practice." It is a reasonable request made in an effort of efficiency. The Request puts Respondents in the position of having to admit whether documents exist or look like they are obstructing discovery. No matter the response, make a note for the Meet and Confer memorandum and follow-up on it.

4. Set a Deadline to Get the Good Stuff

Usually the discussion of List Items involves representations from Respondents' counsel that it is necessary to check with the client whether there are more documents. Set a deadline for Respondents' counsel to confirm the existence of documents. There will be documents. Set a second deadline for production of those documents. Set a deadline for Respondents to provide the affirmations of search.

5. Is There Anything You Need from Claimant?

Towards the end of the call, it may be worth asking Respondents' counsel if there are documents they are still awaiting from Claimant. Whatever the response, memorialize it. It gives a jump on any disputed issue, helps to meet that Rule 12505 "good faith" standard, and often avoids what just happened to Respondents' counsel from occurring to Claimant's counsel.

6. The Meet and Confer Memorialization

After an hour or two on the phone, there is a long list of notes, agreements, agreements to disagree and more. Take the laboring oar and offer (or just inform) Respondents' counsel that Claimant will memorialize the meet and confer effort. Be as detailed as possible for each topic and List Item. This is a working document and is not the place for incendiary advocacy. Neutral reporting will keep the issues on track, make follow-up easy, and not invite pointless counter-fire from Respondents. The memorialization will become Exhibit B to the Motion to Compel if necessary.[14]

Once completed, send a copy of the memorandum to Respondents' counsel and ask for counsel's review and correction of any errors. Sometimes nothing comes back, other times it is a chance clarify a good faith error, or learn Respondents are still not finished qualifying their discovery responses and another meet and confer is necessary.

7. Outside Research on the Respondent Firm's Vendors – Free Discovery!

Sometimes Respondents' counsel does not know or claims not to know much about Respondents' procedures, file architecture, document storage and electronic file architecture. It can be beneficial to ask about the Respondent firm's vendors. Along with being a potential third-party to seek discovery from, vendors usually provide a wealth of resources about their services on their website. Everything from compliance and supervision reports, to e-mail archives, to training materials, to procedures to responding to regulatory and litigation document requests may potentially be found on a vendor's website and/or promotional brochures.[15]

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[14] RICHARD A. LEWINS AND BIRGITTA SIEGEL, *Discovery in Securities Arbitration: Toss Out a Tennis Ball; Get Back a Chewed-Up Slipper*, 16 PIABA BJ 289, 297 (2009).

[15] E.g., Smarsh makes training materials available on-line for its electronic data record storage system. https://central.smarsh.com/s/article/How-Do-I-Search-Content-by-Keywords

8. SEC Record Creation and Retention Rules

Sometimes meet and confer responses from Respondents are that documents were not created or were destroyed in a file purge. There are two sources of information to test the veracity of such a statement. The first is the firm's procedures and compliance manuals. A section on document retention policies is a good place to begin. The second are SEC Rules 17a-3[16] and 17a-4.[17] Rule 17a-3 addresses the documents a brokerage firm must create and maintain. Rule 17a-4 gives the time periods for retaining the documents.

17a-4 gives an additional gift requiring many of the documents, including trade blotters to be maintained *in an easily accessible place*.[18] The "easily accessible place" requirement can significantly change the burden argument, and associated effort to cost-shift discovery to Claimant.

III. CONCLUSION

Getting the Good Stuff requires planning, early scheduling for discovery work, patience, attention to detail, follow-up, more patience, and a solid memorialization. Generally, Respondents want to avoid a motion to compel except for the really Good Stuff (Item 13(b) and Item 20)). By persistent, gentle pushing, many of the issues can be resolved, the Good Stuff produced, and most importantly through the judicious use of affirmations of search, avoid undesirable surprises at the time of hearing.

[16] 17 CFR § 240.17a-3.

[17] 17 CFR § 240.17a-4.

[18] 17 CFR § 240.17a-4(a). "Every member, broker or dealer subject to § 240.17a-3 must preserve for a period of not less than 6 years, the first two years in an easily accessible place, all records required to be made pursuant to § 240.17a-3(a)(1) through (3), (5), and (21) and (22), and analogous records created pursuant to § 240.17a-3(d)."

THE ETHICS OF WITNESS PREPARATION

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I. INTRODUCTION

Consider the following "urban legend" shared with young assistant U.S. attorneys in Washington, D.C., in the 1970s.

> A Public Defender sits with a new client, a young man charged with purse-snatching and arrested in an alley near the crime scene holding the purse. Before the client can say anything, the Public Defender raises his hand and says, "Wait. Let me tell you about a case I just won. I represented a man accused of this same crime. His defense was that he was minding his own business when another man came running by and tossed him a purse. Next thing he knows, he gets arrested. Misidentification. Completely innocent. And the jury found him not guilty. Now — tell me what happened here?" And the client's eyes go wide and he says — "Same thing, it was some other guy!"

If such a client interview ever happened, did the attorney cross the ethical line? Identifying a bright line rule for what lawyers can and cannot do during preparation of witnesses (including their own clients) has been an ongoing challenge. The line between helping a witness give accurate testimony and improperly influencing that testimony has never been easy to draw.

In this article, we will go through the most common ethical areas that are implicated by witness preparation. We will refer to the ABA Model Rules of Professional Conduct (MRPC) as the framework to follow. Each jurisdiction has its own professional rules that may or may not mirror the MRPC, so it is critically important to be familiar with your own jurisdiction's rules, case law, and ethics opinions.

II. COACHING V. PREPARATION

Lawyers must zealously advocate for their clients and are expected to prepare witnesses for the onslaught of questions during their testimony without crossing ethical lines. But where is that line drawn? How do lawyers fulfill their duties to their clients and do what is best for the case without crossing over into unethical territory?

a. Summary of the Law – Interviewing and Preparing Prospective Witness

Coaching in the context of witness preparation has been defined as "obfuscating the truth or instructing the witnesses to lie." *The Ethics of Witness Preparation*, Paul D. Friedman, LawyersUSA (February 25, 2008). The U.S. Supreme Court has observed that an attorney "must respect the important ethical distinction between discussing testimony and seeking improperly to influence it." *Geders v. United States*, 425 U.S. 80, 90 n.3 (1976). Several of the MRPC bear on a lawyer's ethical responsibility when preparing witnesses, which most states have adopted verbatim or in nearly-identical form. A lawyer may not:

1. Counsel or assist a client in conduct that the lawyer knows is criminal or fraudulent (MPRC 1.2(d));
2. Offer evidence that the lawyer knows to be false (MPRC 3.3(a)(4));
3. Counsel or assist a witness to testify falsely (MRPC 3.4(b));
4. Engage in conduct involving dishonesty, fraud, deceit, or misrepresentation (MPRC 8.4(c)); or
5. Engage in conduct prejudicial to the administration of justice (MPRC 8.4(d)).

Many courts impose a knowledge requirement with respect to whether offered evidence is false. "Knowingly" means actual knowledge, but such knowledge may be inferred from circumstances. MPRC 1.0(f). The MRPC's definition suggests that a lawyer may be found to have the requisite state of mind under MRPC 3.4(b) when the evidence shows the lawyer actually knew or *must have known* that his witness preparation would assist a witness in testifying falsely. S*ee Wydick, The Ethics of Witness Coaching*, 17 Cardozo L. Rev. 1, 18 (1995) (requisite knowledge exists when a lawyer knows that witness is practically certain to interpret lawyer's conduct as inducement to testify falsely). This would likely apply to our Public Defender/purse snatcher urban legend. A somewhat stronger view is taken in Professional Conduct and the Preparation of Witnesses for Trial: Defining the Acceptable Limitations of Coaching." 1 Geo. J. Legal Ethics 389, 404 n. 71 (1987), where it is written that it is likely an attorney may be disciplined under MRPC 3.4(b) for constructive knowledge or what attorney should have known.

b. Beyond, "Don't lie."

The place every lawyer in witness preparation should start is instructing their client or witness that they must testify truthfully. Then the lawyer can move to reviewing the matters to be covered with their testimony, anticipating specific questions that may be asked on cross-examination, and reviewing important documents to familiarize or re-familiarize the client with them.

Beyond, "Don't lie," which is essential, there is not a lot of guidance about what is and is not considered acceptable. Courts have confirmed that there is a lot of leeway in preparing a witness ethically: "an attorney enjoys extensive leeway in preparing a witness to testify truthfully, but the attorney crosses a line when she influences the witness to alter testimony in a false or misleading way." *Ibarra v. Baker*, 338 F. App'x 457, 465 (5th Cir. 2009). There exists a grey area where the lawyer helps sculpt testimony which is not false, and which is consistent with what the witness knows or believes, but which is also not entirely the witness's: where the lawyer goes over not only what questions might be asked, but also how the witness ought to answer. There is seldom a time where you tell a client, "this is what will be asked of you," when the client does not respond, "ok, and how should I answer?"

When a lawyer discusses the case with a witness, the lawyer must not try to bend the witness's story or put words in the witness's mouth. As an old New York disciplinary case puts it: "[The lawyer's] duty is to extract the facts from the witness, not to pour them into him; to learn what the witness does know, not to teach him what he ought to know." *In re. Eldridge,* 37 N.Y. 161, 171 (1880). The suggestion from case law is that rehearsing testimony (questions and answers) with a witness is acceptable. Some jurisdictions take a lenient approach, where suggested responses are acceptable so long as they are not actually false. See, e.g., *Hawaii v. Damien Chong*, 949 P 2d 130 (1997).

This permissive approach has been reflected in the *Restatement of the Law Governing Lawyers*, Section 116, which allows lawyers to "suggest words that might be employed to make the witness's meaning clear." That approach has also been endorsed by the Washington D.C. Bar:

"A lawyer may not prepare, or assist in preparing, testimony the lawyer knows is false or misleading. However, so long as a lawyer does not violate this prohibition, a lawyer may suggest language and even the substance of a witness' testimony in preparing the witness." District of Columbia Legal Ethics, D.C. Ethical Opinion No. 79, (1979) (emphasis added). While it might not be unethical to do so, the witness's credibility might be hurt if her testimony sounds very rehearsed.

c. Lawyer Repercussions

Ethical discipline for improper witness preparation is rare. Reported disciplinary cases on attempts to influence testimony usually involve subornation of perjury or similarly flagrant misconduct in which the lawyer overtly tries to induce clients or witnesses to give testimony that the lawyer knows is false or knows that the witness believes is false. *See e.g., In re Attorney Discipline Matter*, 98 F.3d 1082 (CA 8 1996); *In re Mitchell*, 262 SE 2d 89 (Ga. Sup.Ct. 1979); *Goodsell v Mississippi Bar*, 667 So.2d 7 (Miss. Sup.Ct. 1996); *Harrison v Mississippi Bar*, 637 So. 2d 207 (Miss. Sup.Ct. 1994); *In re Oberhellmann*, 873 S.W.2d 851 (Mo. Sup.Ct. 1994); *In re Edson*, 530 A.2d 1246 (NJ Sup.Ct. 1987); *In re Stroh*, 644 P.2d 1161 (Wash. Sup.Ct. 1982).

III. CORRECTION OF TESTIMONY

Under MRPC 3.3(a)(3), a lawyer is required to take remedial measures (including if necessary, disclosure to the tribunal), if the lawyer knows his/her client has offered evidence that is material and the lawyer knows is false. Likewise, under Rule 3.3(b), "A lawyer who represents a client in an adjudicative proceeding and who knows that a person intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal".

The Comments also provide some background. Comment 6 to MPRC 3.3 states that if a lawyer knows that her client intends on providing false evidence, the lawyer should try to convince the client otherwise. If unsuccessful, the lawyer must refuse to offer the false evidence.

Comment 10 provides insight on what happens when false evidence has already been offered. If such has happened, the lawyer is required to take remedial measures. The first course of action is to talk with the client confidentially, advise them of the lawyer's duty, and ask the client to withdrawal or correction of the false evidence. "If withdrawal from the representation is not permitted or will not undo the effect of the false evidence, the advocate must make such disclosure to the tribunal as is reasonably necessary to remedy the situation, even if doing so requires the lawyer to reveal information that otherwise would be protected by Rule 1.6". *See* Comment 10 to MRPC 3.3.

Comment 15 provides that under extreme circumstances, the lawyer may withdraw from representation "if the lawyer's compliance with this Rule's duty of candor results in such an extreme deterioration of the client-lawyer relationship that the lawyer can no longer competently represent the client." *See* Comment 15 to MRPC 3.3.

IV. LAY WITNESSES

a. Payment of Testimony

Rule 3.4 of the MRPC discusses "Fairness to Opposing Party and Counsel". Subsection (b) states that a lawyer shall not "offer an inducement to a witness that is prohibited by law", but states nothing further.

Instead, Comment 3 states that "it is not improper to pay a witness's expenses or to compensate an expert witness on terms permitted by law. The common law rule in most jurisdictions is that it is improper to pay an occurrence witness any fee for testifying and that it is improper to pay an expert witness a contingent fee".

The ABA has construed Rule 3.4 and Comment 3 to allow compensation to fact witnesses for time lost preparing to testify and testifying on the basis that such compensation is not the equivalent to paying a fee to testify. *See* "Your Witness", *Los Angeles Lawyer*, Marcellus A. McRae and Kim Nortman at 2 (Sept. 2012), *citing ABA Comm. on Ethics and Professional Responsibility, Op. No. 96-402*. Under the ABA's interpretation of Rule 3.4, a party may compensate a third-party fact witness for:

a) time lost attending a deposition or trial,
b) meeting with a lawyer to prepare such testimony, or
c) reviewing or researching documents relevant to such testimony,
d) so long as the payment is reasonable, and not conditioned on the fact of testifying or the content of the testimony.

Id. at 2.

As an example, California RPC 3.4 provides a variation to MRPC 3.4, which prohibits a lawyer from directly or indirectly paying, offering to pay, or acquiescing in the payment of compensation to a witness contingent upon the content of the witness's testimony or the outcome of the case. Except where prohibited by law, a lawyer may advance, guarantee, or acquiesce in the payment of: (1) expenses reasonably incurred by a witness in attending or testifying; (2) reasonable compensation to a witness for loss of time in attending or testifying; or (3) a reasonable fee for the professional services of an expert witness

See CRPC 3.4(d).

Similarly, Florida RPC 4-3.4 allows "a lawyer may pay a witness reasonable expenses incurred by the witness in attending or testifying at proceedings; a reasonable, non-contingent fee for professional services of an expert witness; and reasonable compensation to a witness for the time spent preparing for, attending, or testifying at proceedings." *See* FRPC 4-3.4(b). As of December 2018, every state (except Puerto Rico) has adopted some close variation of this rule.

Should you decide to pay a fact witness, you may consider drafting a written agreement with the witness. It should disclose that the payment is for lost time and expense and that such a payment is not contingent on the outcome of the case. A lawyer should also presume that such an agreement will likely be discoverable to opposing counsel and will likely be viewed by the arbitrators or judge.

b. Employees of Respondent

Under MRCP Rule 4.2, a lawyer cannot communicate with a person the lawyer knows to be represented by another lawyer in the matter, without the other lawyer's consent or authorized by law or a court order. Comment 4 to MPRC 4.2 states that this does not apply to matters outside the scope of representation (such as speaking with a person about a regulatory matter vs. an arbitration case). Most states use MPRC 4.2 verbatim or have a similar rule.

But what do you do about employees of a corporation or LLC? Comment 7 to MPRC 4.2 discusses this issue to some degree:

> In the case of a represented organization, this Rule prohibits communications with a constituent of the organization who supervises, directs or regularly consults with the organization's lawyer concerning the matter or has authority to obligate the organization with respect to the matter **or whose act or omission in connection with the matter may be imputed to the organization for purposes of civil or criminal liability**. Consent of the organization's lawyer is not required for communication with a **former** constituent. If a constituent of the organization is represented in the matter by his or her own counsel, the consent by that counsel to a communication will be sufficient for purposes of this Rule. Compare Rule 3.4(f). In communicating with a current or former constituent of an organization, a lawyer must not use methods of obtaining evidence that violate the legal rights of the organization. See Rule 4.4.

See Comment 7, MPRC 4.2 (emphasis added). Essentially, you are prohibited from contacting high-ranking employees of the organization and those directly involved in harming your client.

So who does the attorney for the corporation or LLC represent? Typically, this rule covers communications with owners, board of directors, officers, and in some cases high-level managers. However, lower-level employees generally are not covered. To determine whether an employee falls under this rule, states and federal courts several use different tests:

i. **Managing-Speaking Test** - Under the "managing-speaking agent" test, a represented "party" or "person" "is only those employees who have the legal authority to 'bind' the corporation in a legal evidentiary sense, *i.e.*, those employees who have 'speaking authority' for the corporation." ***Palmer v. Pioneer Inn Assocs., Ltd.***, 59 P.3d 1237, 1248 (Nev. 2002); *see also Wright v. Group Health Hosp.*, 691 P.2d 564 (Wash. 1984).

ii. **Control Group Test** - Other courts have applied the "control group" test. *See Fair Automotive Repair, Inc. v. Car-X Serv. Sys., Inc.*, 471 N.E.2d 554 (Ill. App. 1984). Under this test, attorneys cannot communicate with "only to those employees within the corporation's 'control group,' which is defined as those top management persons who had the responsibility of making final decisions and those employees whose advisory roles to top management are such that a decision would not normally be made without those persons' advice or opinion or whose opinions in fact form the basis of any final decision". *Id.* at 560. This rule allows for opposing attorneys to communicate with more employees.

iii. **Party-Opponent Admission Test** - A few courts have also used the "party-opponent admission" test. *See Cole v. Appalachian Power Co.*, 903 F. Supp. 975 (S.D. W.Va. 1995); *Brown v. St. Joseph County*, 148 F.R.D. 246 (N.D. Ind. 1993); *University Patients, Inc. v. Klingman*, 737 F. Supp. 325 (E.D. Pa. 1990); *see also Weeks v. Independent School Dist. I-89*, 230 F.3d 1201 (10th Cir. 2000). This is derived from F.R.E. 801(d), which states that an employee's statement is not hearsay and thus is freely admissible against the employer, if it concerns a matter within the scope of employment and made during the employment. *See* F.R.E. 801(d)(2)(D). To protect an employer, this test finds that most employees are covered, and thus, attorneys may be very limited in talking with current employees.

iv. **Blanket Test** - Very few courts have used a "blanket" test, which prohibits contact with any current or former employees (*Public Serv. Elec. & Gas v. Associated Elec. & Gas*, 745 F. Supp. 1037 (D.N.J. 1990), but this is seldom used.

v. **Alter Ego Test** - New York has applied its own test, sometimes called the "alter ego" test. *See Niesig v. Team 1*, 76 N.Y.2d 363 (1990). This found the blanket test to be too broad and the control group test to be too narrow. Instead, it defined "party" to "include corporate employees whose acts or omissions in the matter under inquiry are binding on the corporation (in effect, the corporation's "alter egos") or imputed to the corporation for purposes of its liability, or employees implementing the advice of counsel". *Id*. at 374.

Thus, before contacting employees, you should figure out which test your jurisdiction uses, and be careful to research both state *and* federal law to determine such.

If you are contacting former employees of the organization, you generally are allowed to speak with the employee, subject to other ethical rules, such as MPRC 4.3. MPRC 4.3 states that in dealing with unrepresented parties, the lawyer should not state or imply that the lawyer is disinterested, and the lawyer is required to make reasonable efforts to correct any misunderstanding to the contrary.

Sometimes it may be best to have your client contact the person first, especially if your client knows the potential witness. Potential witnesses who are contacted by attorneys may be defensive when speaking with an attorney, but they may be more open to speaking with your client.

Practically speaking, you may consider asking the person/employee whether they have an attorney first. If they do, you should cease communications and speak directly with their attorney.

V. EXPERT WITNESS PREPARATION

Lawyers have an ethical obligation to present expert witness evidence that complies with any applicable admissibility standards and procedural rules. Presenting expert witness testimony implicates several ethics rules that practitioners should understand. The primary ethics rules that apply to expert witness testimony are MPRC 3.1 (meritorious claims and contentions), MPRC 3.3 (candor to the tribunal), MPRC 3.4(b) (presenting false evidence or assisting a witness to testify

falsely), and MPRC 4.4 (respect for rights of third parties.) These rules attach to four situations that lawyers commonly deal with when presenting expert testimony.

a. Lawyer as a Gatekeeper

Should a lawyer act as a "gatekeeper" or as an advocate concerning the reliability of expert witness testimony and evidence he or she offers? If a lawyer has doubts regarding an expert's qualifications, opinions, methods, or bias, what ethical obligations, if any, does the lawyer have to exercise additional diligence or to make further inquiry to resolve any reservations and to confirm the legal reliability of the expert's opinion?

The conflict that exists between a lawyer's duty to zealously represent his or her client and a lawyer's duty to the court as an officer of the court is common and complicated. This complex balancing act highlights the strain that exists between what ethics rules allow and what professionalism may not allow. MPRC 3.3(a)(3) provides, "A lawyer shall not knowingly... offer evidence that the lawyer knows to be false. If a lawyer, the lawyer's client, or a witness called by the lawyer, has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal." Comment 8 to MPRC 3.3 provides:

> [8] The prohibition against offering false evidence only applies if the lawyer knows that the evidence is false. A lawyer's reasonable belief that evidence is false does not preclude its presentation to the trier of fact. **A lawyer's knowledge that evidence is false, however, can be inferred from the circumstances**. See Rule 1.0(f). Thus, although a lawyer should resolve doubts about the veracity of testimony or other evidence in favor of the client, the lawyer cannot ignore an obvious falsehood. (emphasis added).

Knowing testimony is false versus reasonably believing it is false is a tough distinction to make. The "reasonable belief" language in ER 3.3(a)(3) and in comment 8 has been interpreted to mean that the lawyer has "genuine and reasonable doubt" as to falsity. If a lawyer's belief that the expert's evidence may be false is sufficiently certain that the lawyer can have no "genuine or reasonable" doubt as to its falsity, then the lawyer "knows" that the evidence is false and is precluded from presenting it to the court. *See, e.g., In re Gordon*, 780 F.3d 156, 157 (2d Cir. 2015).

A lawyer's reasonable doubts regarding the reliability or falsity of an expert's testimony also may be transformed into actual or constructive knowledge of falsity if the lawyer's exercise of due diligence and inquiry would have confirmed the falsity of the expert's testimony. *See U.S. v. Shaffer Equipment Co*., 11 F.3d 450 (4th Cir. 1993) (Government offered evidence through an expert with false credentials); David L. Faigman, et al., *Enforcing ethical standards—The sponsoring lawyer's duty to police experts*, 1 Mod. Sci. Evidence § 2:12 (it is "not only ethically irresponsible for a lawyer not to perform 'due diligence' on prospective experts, but also foolish.").

Thus, it is clear that a lawyer cannot ignore doubts or questions regarding the validity or reliability of his or her expert's evidence where reasonable and diligent inquiry would confirm the falsity of the expert's analysis and opinions. Lawyers have an ethical duty, for example, to reassess the reliability, validity, integrity, and relevance of proffered expert evidence in light of fallacies, deficiencies, and erroneous assumptions that may be revealed in discovery or in a Daubert or Frye challenge to the expert's testimony. *See, e.g., Shaffer Equip*. Co., 11 F.3d 450, 459 (4th Cir. 1993) ("While it is true that a mere suspicion of perjury by a client does not carry with it the obligation to reveal that suspicion to the court under Rule 3.3, . . . the government's attorneys in

this case cannot find shelter behind any such doubt."); *Projects Mgmt. Co. v. Dyncorp Int'l LLC*, 734 F.3d 366 (4th Cir. 2013); *Richardson v. Cabarrus Cty. Bd. of Educ*., 151 F.3d 1030 (4th Cir. 1998).

One obvious indicator of falsity exists when the expert witness offers contradictory testimony. The expert's contradictory statements may occur within the same litigation, or the expert may offer testimony that differs from prior testimony (affidavits, depositions or trial) in an unrelated proceeding. If the circumstances are such that the lawyer should have known of the contradiction, the lawyer knows of the falsity of the expert's evidence, and thus may not offer it. Contradictory testimony from an expert indicates "an obvious falsehood" that a lawyer cannot ignore. (*See* ABA Model Rule of Professional Conduct 3.3 [Comment 8], and *In re Peasley*, 90 P.3d 764 (Ariz. 2004) (attorney disbarred for eliciting conflicting, and therefore obviously false testimony, from the same witness in two separate trials).

The prevailing attitude appears to be that lawyers do not (and cannot) vouch for the truth and validity of expert evidence. Although lawyers perhaps cannot "vouch" for such truth and reliability, certainly lawyers can—and should be required to—perform a limited gatekeeper role. The lawyer offering expert testimony is the person best situated to assess issues such as whether:

- the expert's qualifications and experience are sufficient
- the theories or methodologies used are scientifically sound or accepted in the industry or profession
- the theories or opinions of the expert witness exceed the reasonable limits of his or her expertise or experience
- the inductive or deductive reasoning employed by the expert is reasonable and trustworthy
- the expert's data and investigation are adequate
- and other such issues relevant to the credibility and reliability of the expert's evidence.

A lawyer has an ethical duty to scrutinize his or her own expert's testimony and to refrain from offering expert evidence that would be untruthful, unsupported, unreliable, invalid, or misleading to the trier of fact. If a lawyer has doubts or questions regarding the validity or reliability of his or her expert's testimony (or reasonably should have such doubts based on the facts and circumstances), the lawyer must pursue a reasonable and diligent inquiry that will resolve such doubts and questions.

Advocacy obligations notwithstanding, a lawyer obviously should not attempt to elicit opinions from an expert witness that the lawyer knows or reasonably should know are beyond the witness's expertise. According to one commentator, however, these positions represent an extreme view of the obligations imposed under the ethical rules. The prohibitions of MPRC 3.4(b) do clearly appear to apply to a situation in which the lawyer actually knows or should have known the falsity of an expert's testimony, as where the expert offers contradictory testimony. Once the expert gives contradictory testimony, the lawyer has actual or constructive knowledge of its falsity. Appropriate remedial measures would become necessary under MPRC 3.3(a)(3) and the lawyer must, under MPRC 3.4(b), refrain from "assisting" the expert witness to testify falsely.

b. Fees for Expert Witnesses

It is not improper to pay a witness's expenses or to compensate an expert witness on terms permitted by law. However, the common law rule in most jurisdictions is that you cannot ethically compensate your expert witnesses on a contingency basis – the expert witness only gets paid if you win the case.

c. Procuring Favorable Testimony from an Expert

Lawyers may not make false statements to a tribunal and they may not encourage their experts to make false statements to a tribunal. Comment 2 to Rule 3.3 provides additional guidance on this issue:

> This Rule sets forth the special duties of lawyers as officers of the court to avoid conduct that undermines the integrity of the adjudicative process. A lawyer acting as an advocate in an adjudicative proceeding has an obligation to present the client's case with persuasive force. Performance of that duty while maintaining confidences of the client, however, is qualified by the advocate's duty of candor to the tribunal. Consequently, although a lawyer in an adversary proceeding is not required to present an impartial exposition of the law or to vouch for the evidence submitted in a cause, the lawyer must not allow the tribunal to be misled by false statements of law or fact or evidence that the lawyer knows to be false.

It has been suggested that the language of MPRC 3.4(b), which precludes false evidence or assisting a witness to testify falsely, imposes ethical requirements for expert witness testimony. The suggestion is that MPRC 3.4(b) "forbids an attorney to permit an expert witness to testify as an expert in an area that is not scientifically valid." Obviously, this statement may be accurate where the testimony will be offered based on indisputably invalid scientific theories or methods. Also, it has been argued that MRPC 3.4(b) "forbids the lawyer to coax opinions from the expert that are beyond the realm of the expert's specialized knowledge." Justin P. Murphy, *Expert Witnesses at Trial: Where Are the Ethics?* 14 GEORGETOWN J. LEGAL ETHICS 217, 230 (Fall 2000).

Willfully suborning perjury from an expert witness in a grand jury is also obstruction of justice under 18 U.S.C. § 1512. *See, e.g. Snowden v. Cazares*, 2015 U.S. Dist. LEXIS 193056 (C.D. Cal. Dec. 15, 2015) (defendants' willfully suborning perjury from and/or attempting to influence, delay, or prevent the testimony of an expert witness in a Grant Jury proceeding was a violation of 18 U.S.C. § 1512(b)(1): tampering with a witness, victim, or informant.").

d. Interactions with Adverse Experts

MPRC 3.4(d) provides that a lawyer cannot allude to any matter that the lawyer does not reasonably believe is relevant or that will not be supported by admissible evidence, assert personal knowledge of facts in issue except when testifying as a witness, or state a personal opinion as to the justness of a cause, the credibility of a witness, the culpability of a civil litigant or the guilt or innocence of an accused. These prohibitions extend to intimidation and witness tampering. *See, e.g.*, *Sutch v. Roxborough Mem'l Hosp.,* 2016 BL 380025, No. 1836 EDA 2015 (Pa. Sup. Ct. 2016) [intimidation of opposing party's expert warranted disqualification and monetary sanction]; and *Erickson v. Newmar Corp.*, 87 F.3d 298 (9th Cir. 1996) [witness tampering].

Litigators should also be cautious about contact with experts outside of the courtroom. *See, e.g.*, *Lewis v. Telephone Employees Credit Union*, 87 F.3d 1537 (9th Cir. 1996) [testimony may be excluded based on *ex parte* contact with expert witness]. *See also County of Los Angeles v. Sup. Ct. (Hernandez)*, 222 Cal.App.3d 647 (1990) [disqualification may be mandatory where the plaintiff's counsel who employed expert previously employed (but subsequently withdrawn) by the defendant was disqualified from representing the plaintiff as a result of access to the work product of defendant's counsel (expert's report)]. *Ethics Issues in the Use of Expert Witnesses,* Neil J. Wertlieb, *The Professional Lawyer*, Vol. 24, No. 3.

A PRIMER ON REAL ESTATE, REAL ESTATE FRAUD, AND FRAUDULENT TRANSFERS INVOLVING LIFE INSURANCE FOR SECURITIES ARBITRATION PRACTITIONERS

This seminar will focus on the basics of real estate for attorneys, followed by commercial real estate investment fraud and related remedies, and finally, we will analyze fraudulent transfers by Ponzi promoters to life insurance products.[1]

Securities lawyers are sometimes confronted with securities investments that are not typical stocks, bonds, funds, or securities traded on national exchanges. These so-called "alternative investments" or "private placements" have, in recent memory, included instances of investments in commercial or residential real estate, credit card merchant accounts, debentures or investment contracts tied to other illiquid investments. See generally, FINRA Rule 2310 (direct participation programs include real estate investments). This seminar is designed to provide securities practitioners with a refresher course on real estate, and selected examples of litigation tied to real estate. Lastly, this article will review an unusual area of investment fraud, being life insurance tied to investment fraud.

THE BASICS OF COMMERCIAL REAL ESTATE

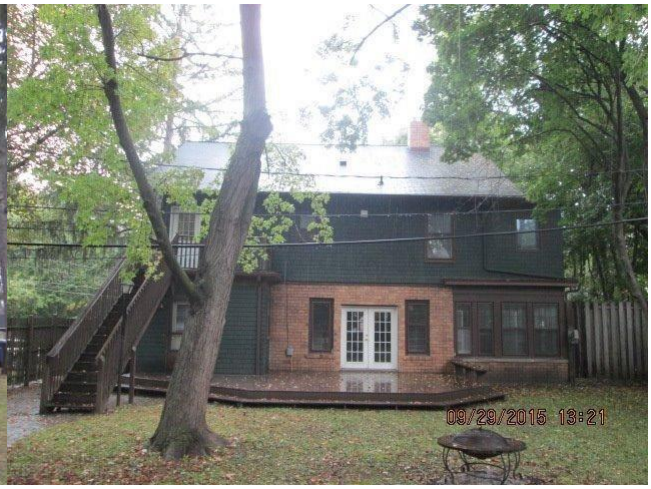
Terri Sonn

(or as I like to tell it, how to be a financial advisor for those who buy real estate and think that it is like a stock)

What is commercial real estate?

Commercial real estate is the ownership of any land that you do not live in for your own personal use.





[1] Jeff Sonn, Moderator, Sonn Law Group; Terri Sonn, Sonn & Mittelman PA; James Sallah, Sallah, Astarita & Cox PA.



This is our house in Ann Arbor Michigan – but it really isn't. We bought this 8-bedroom duplex so that our son could live there while he went attended the University of Michigan. We rented six rooms to tenants and the 7th room was for our son. This is an example of commercial real estate.



This is an example of commercial real estate. Some of you, during the pandemic or otherwise, have thought about having a little bit of land to farm so that you are not so reliant upon our food distribution center. Some of you (at least one member of Piaba) figured out a way to buy farmland, finance it through government conservation easements, and get reimbursed for all of your closing costs. That is definitely a form of commercial real estate



This is an image of the Everglades. Florida used to be known for having unscrupulous developers buy acres of land for $1.00 and sell it to unwitting investors who want to retire to Florida. This is an example of commercial and residential real estate. This happened to one of my clients. The rumor has it, that his father purchased what he thought was prime property to develop in Florida. He held it for years and when he came down to Florida to see what he could do with it, it looked like this. Disclaimer: I do not know that the story is true, but it sounds good. After his father passed, my client figured something out. He pulled a permit to drill for oil on the land and the government just paid him over more than $10 million to not drill. Just another example of commercial real estate.

And then, there are these types of commercial real estate.

Apartment Buildings



Restaurants



Industrial Properties



Malls



Charter Schools



These are some of the types of deals which I am currently working on.

There is nothing different between buying a home and buying commercial real estate. There is a contract, there are title issues, there are survey issues (with homes it usually boils down to fence disputes and whose tree is encroaching on the other's yard), there are zoning issues, there are environmental issues, there are "force majeure issues", there may be financing issues and of course, there are disputes, and if you are lucky and everything goes according to plan, you have a closing.

A. The Contract. I am appending to this article, the Florida Board of Realtor's Contract Form, which is very similar to the Florida Bar From.[2] It is for reference only. Every state has a different form of contract. I am kind of partial to the Florida form because I helped write it back in 1993 and it has gone through many iterations over the years but it is still our basic form as modified by case law.

1. You have a buyer and a seller. That may seem easy but, if the seller is married and the wife does not sign the contract, you have an invalid contract. If the buyer signs the contract but he uses his brother's name instead of his own, then you have a problem. If the contract extends out for more than a year and you don't have two witnesses on it (for Florida only) then it is invalid. Does a napkin agreement to buy real estate work in every state? No. In some states it does, in some states it doesn't. What happens if you have a Delaware corporation as a Seller and you don't know who the members are? The "sole member" signs an

[2] See Appendix 1.

affidavit stating that he is the only member and three years down the road, you find out that there are 5 other members who didn't know about the transaction? What happens if you sign a contract in your individual name, but you choose to take title (for liability purposes) in a corporate name, can you? What happens if you have a real estate trust but one of the trustees becomes incapacitated during the transaction, there is no successor trustee alive and it is a 1031 deal with timing issues? What happens if there is financing? We will get to that later.

2. You have a purchase price. On a commercial property, it can vary because of installments sales issues. Another issue with purchase price is it can be calculated per acre, per cubic yard (especially for fill or other mineral extractions), per lot completed with a percentage of homes actually sold. Purchase Price is an amorphous concept in commercial property but it is one of the easiest elements to mess up in commercial deals if it is not properly defined.

3. Last but never least is the Property. The fourth element of our contract concept. As you all learned in law school, property is unique. So, usually we only refer to properties by their legal descriptions. So a folio number doesn't count, or does it. An address doesn't count, or does it? How many street addresses are there that are 100 SE 1st Street? For title insurance purposes, you can misspell the name of the Plat as long as it is lot and block and the recording pages are correct. But how many times can you say the NW Corner of the NE corner of the SW corner of such and such a Plat. My favorite is Florida Fruit lands. And some plats were recorded in one county 100 years ago but are located in different counties today.

So all of the above constitute the basics of commercial property. The three P's and it is not the PPP loans, it is Parties, Price, Property. You also need a definitive closing date but that not part of my discussion.

B. Should people invest in commercial property? This goes back to my concept earlier as lawyers sometimes counseling the client beyond the contract itself. Does your client have disposable income? Can the client afford the risk? How old is the client? What kind of risk can the client take?

1. Example 1 True Story: My son's friend (35) calls me up and says, "I have $300,000" to invest in real property on Miami Beach. Find me a deal." Apparently, his friend's friend bought a triplex in West Miami and was making lots of money on rent. He wanted the same thing. West Miami is predominantly Hispanic. My son's friend spoke English and German, no Spanish. He would have to hire a property manager. The property manager takes one month's rent as a fee. Cap rate on the deal without financing would be about 6.5% before paying the property manager. I didn't consider this to be a good investment.

For those of you that don't know, a **cap rate** is the rate of return on your capital invested in a property. Example, you have a tenant that pays $100,000 a year in rent. Purchase Price of Property is $1,000,000. Ten percent is the cap rate. If the Property is Triple Net, meaning all expenses are paid for by the tenant, then you walk away with ten percent cash on cash return. It doesn't take into account what the land is valued at, what you can sell it for or what other uses for which you can sell the land. It is a money value concept. Stand-alone tenants tend to have this type of structure. They are called Triple Net or NNN and are basically considered like bond deals

if you have a credit tenant. A Credit tenant is one where a bank will lend you money against your lease because the tenant is credit worthy, such as a national tenant like McDonalds, Starbucks or 7Eleven. Sometimes, an insurance company will even loan you money, without any personal guarantee against a credit tenant Triple net lease deal, also called a nonrecourse loan deal. That type of deal allows you to leverage your money against a much larger deal, and a lender may loan as much as 70% of the purchase price on larger deals, typically more than $2 million. There, the national credit tenant pays you rent on your property and you just sit back and collect rent and let the tenant do all the maintenance, pay the taxes, and all insurance. Those types of deals I view the same as buying a conservative to moderate risk bond. To give you an idea of current cap rates on triple net leased deals involving well known tenants, I attach a list of currently offered Triple Net Leased deals from one of the national NNN brokers. According to a net lease market report, national asking cap rates are 6.15% in the retail sector; 7% in the office sector; and 7.05% in the industrial sector.[3]

Malls lease to tenants under a gross rent structure (similar to the above) but the owners do all the work on the buildings and not the tenants. If you are a tenant in a Simon Mall or some similar type of mall, not only do you pay rent, you also pay advertising fees, marketing fees, and a portion of common area maintenance and even a portion of gross sales (over a certain base rent). These types of deals presume that the Landlord does not have to pay taxes, insurance, maintenance and other forms of upkeep no matter who performs the maintenance work.

What happens to a rate of return if there are un-reimbursed expenses? Let's go back to the above example: purchase price is $1,000,000. Tenant pays $100,000 per year rent and the landlord must pay for all expenses of the property: taxes, insurance, maintenance, etc. In Miami, a commercial property at $1,000,000 with a tenant has a tax rate of plus or minus depending upon the neighborhood $25,000. So immediately your cash on cash return is reduced from 10% to 7.5%. Then insurance, lawn care, roof, HVAC, ... your rate of return drops rapidly if you have a gross lease. You also pay 7% in sales tax to the state of Florida on gross rents received. That would be a loss of another $7,000. What was originally a good deal no longer looks so hot.

Then there is a middle ground, what we call double net (NN). That's generally where the Landlord pays for roof and structure maintenance and repair for the building while the Tenants pay for taxes and insurance. Landlords sometimes pay for insurance and the tenant reimburses. A good example of this is a Starbuck's lease. SBX under most of its current leases, maintains the property (parking, interior, HVAC) but not the roof, structure, parking replacement (potholes) or water lines from the street to the building.

My favorite horror story on a double net lease: my client owned a Lowe's in Texas. Lowe's was to maintain the landscaped areas of the parking lot and the surface of the parking lot. The 100-year flood hit that year. Water seeped into the subsurface of the parking lot. During the flood, Lowe's forgot to turn off its sprinklers. Within 1 month of the flood, the parking lot started to crack with potholes and structural breaks. Lowes patched it with a different material than it was actually built with. Then the gardens section of the store started to sink into the ground because of the subsurface damage. Lowe's got an estimate to re-do the parking lot and corner of the building for $1,000,000. We told them that if Lowe's had turned off the sprinklers after the flood and

[3] The Boulder Group, publishes various net lease market reports. Appended hereto as Appendix 2 is The Net Lease Market Report, Q2 2020; The Net Lease Casual Dining Market Report Q1 2020; The Net Lease Big Box Report, Q4 2019; The Net Lease Bank Ground Lease Report Q1 2020; The Net Lease Drug Store Report; The Net Lease QSR (Quick Service Restaurant) Report Q2 2019, for examples of cap rates.

properly patched the parking lot, that the damage would not have been as bad. We had video of the sprinklers on and bubbling under water. It looked like a hot tub. Obviously, this was settled, but if this weren't Lowe's with deep pockets and my client didn't have cash to contribute, this would not have ended so nicely. But these are just instances where being a landlord may be more than just buying a piece of property and expecting a return.

So, going back to the example of my son's friend, should he have bought the duplex or triplex in West Miami? Factors to consider
:

a. Diversity? What are his other assets? Does he have liquid cash over and above the initial $300,000 investment just in case something goes wrong? We spoke earlier about all unknown contingencies with some properties. I didn't touch upon what happens when the government says to your tenants during a pandemic, such that the landlord cannot evict you if you don't have money to pay rent. Banks and Landlords are now going on 4 months of no rent. That certainly changes the cap rate and puts the landlord at risk with its mortgagees. Then, also from a commercial landlord perspective, if your tenant files for chapter 7 or chapter11, that is another risk. Or what happens with casualties and insurance company delays. I know of instances where after a hurricane, it takes a year to get a settlement with an insurance company while you have not paid your lender and have not received rent. Assets are necessary for the rainy-day deals.

b. Sophistication? Does the purchaser understand what he/she is purchasing and understand the risks? As in the situation earlier, does your client understand how much will be required to maintain a property? Does the client have the wear-with-all to know how to maintain toilets or have clients calling you in the middle of the night or knowing how to hire a management company so that the manager does not run away with all the money?

Example, a client does not speak Spanish. Client hired husband and wife to be the on-site manager a 50-unit section 8 housing unit. Managers received $1,500 a month plus a free unit as their salary. This was a very sophisticated owner but bought in a lower income neighborhood on Miami Beach. They bought for future land growth and not necessarily an immediate return on investment. Anyway, after about a year and a half, rents go down dramatically, $500 a month here, $2,500 there: differing per month. Managers state that the tenant are not paying. Evictions are filed and the tenants claim that the managers are pocketing the rents. Owner then has to evict the Managers and file police reports, etc., with sworn affidavits from the tenants that the Owner was trying to evict. Owner lost out on over $35,000 in one year due a criminal manager.

c. Patience and financial ability to wait. Sometimes investors buy property for one use, and after the life of the lease, it is no longer good for that use. The investor must have the ability to think outside the box and re-develop the property or be able to withstand selling the property for significantly less than originally planned.

These issues are no different than whether a stockbroker should sell a stock to an individual. The difference is the initial cost and the liquidity of the product. Real Property is inherently not liquid.

So, a final example. True Story: A broker calls me up, “I heard you are the best at NNN (Triple Net) deals. I have a client from CA that is buying a deal in Orlando, will you help him?” “Sure” I respond. Give me his number and I will call him. Broker, “but we need to get the deal done. Don’t blow the deal.” Ugh.

Now, what is a Triple Net? A triple net lease (triple-Net or NNN) is a lease agreement on a property where the tenant promises to pay monthly rent, net of all the expenses of the property. Meaning the tenant pays the landlord rent, and the tenant pays the three big expenses of the property, namely real estate taxes, insurance and all common area maintenance. So, of the roof leaks, the tenant fixes it. If the parking lot needs to be repaved, the tenant pays for it. Typically the responsibility of the landlord in the absence of a triple, double, or single net lease is to pay the taxes, insurance and maintenance, but not in a triple net lease deal. In a typical double net lease deal, the landlord is only responsible for roof and structure, but all other maintenance, taxes and insurance are paid by the tenant.

Now, back to our triple net deal I call the man up and ask him to tell me about the deal, what he wants and what he expects. Man is 86, wife is 84. One child, two grandchildren and one great grandchild. He is selling a 16-unit rental property in California and wants to reinvest it with a NNN deal here in Florida. Tax issues and depreciation are guiding him. He also says that he wants something simple. His son is 60, is not sophisticated, so he wants to buy something so that when he dies, his son will receive income and not have to spend too much time worrying about the Property.

Clearly, this man is sophisticated. He is doing a 1031 (tax free exchange) to save on taxes and thought out everything thoroughly. I used the term 1031 tax free exchange. A “1031 exchange,” also known as a real estate exchange or a tax-deferred exchange, occurs when the proceeds from one sale are used in a subsequent purchase of another piece of real estate.[4] If you make a like-kind exchange, you are not required to recognize a gain or loss under Internal Revenue Code Section 1031. If, as part of the exchange, you also receive other (not like-kind) property or money, you must recognize a gain to the extent of the other property and money received. You can’t recognize a loss.

[4] For an example of a fraud case involving an investor and a 1031 exchange, See Appendix 7. There, the financial advisor fraudulently issued a letter to the 1031 intermediary, after the 45-day deadline to identify the like kind property (without telling the investor). And, the financial advisor failed to tell the investors that the primary tenant of the office building to be purchased had bought land and intended to move as soon as the new building was built. Had the advisor conducted any due diligence, the advisor would have learned of the major tenant’s plans.



Back to our deal. I spoke with his accountant and his local lawyer to make sure that all of the information was correct and didn't need the cash (regardless of tax consequences) and now I am assisting him with his purchase. But I have also had elderly clients call me and tell me that they want to invest in real estate because the stock market is not giving them a return on their money and a broker has told them about this NNN deal that they should invest all of their liquid cash into so that they can receive a passive income. That isn't smart either. There has to be a balance.

So, in my client's situation, the sale of his 16-unit building (which he bought for $500,000 and is selling for 2.6 million), and his purchase of a NNN property for $2.4 million, qualifies as a tax-free exchange. He held onto this building for almost 25 years, has almost fully depreciated it and is looking for something that is more stable. He will not recognize any gain on the money he puts into his new purchase but the money he has left over and is not re-investing in another deal, he will pay taxes on. [5]

Bottom line: Buying and selling real estate is almost like buying or selling a stock, it is just far less liquid and typically more expensive.

[5] The main idea here is you shouldn't have to pay capital gains if your intention is to immediately turn around and buy a similar property with the proceeds. 1031's only apply to exchanges of real property and not to exchanges of personal or intangible property. And effective January 1, 2018, exchanges of machinery, equipment, vehicles, artwork, collectibles, patents and other intellectual property and intangible business assets generally do not qualify for non-recognition of gain or loss as like-kind exchanges. However, certain exchanges of mutual ditch, reservoir or irrigation stock are eligible for non-recognition of gain or loss as like-kind exchanges. Like-Kind Property: Properties are of like-kind if they're of the same nature or character, even if they differ in grade or quality. Real properties generally are of like-kind, regardless of whether they're improved or unimproved. For example, an apartment building would generally be like-kind to another apartment building. However, real property in the United States is not like-kind to real property outside the United States.

REAL ESTATE INVESTMENTS AND NONTRADITIONAL ASSET BACKED INVESTMENT FRAUD

Jeff Sonn

In recent years, some financial advisors have been selling alternative investments in commercial and residential real estate, as well as merchant accounts or small business loans, only to later be revealed as Ponzi schemes. In December, 2017, it was revealed that California developer Robert Shapiro masterminded a $1. 2 billion Ponzi Scheme through his company, known as Woodbridge Group of Companies LLC ("Woodbridge Group"). See SEC vs. Robert H. Shapiro, Case 17-24624 (SDFL 2017). In 2018, it was revealed that Carl Ruderman, through his company, 1 Global, masterminded a $280 million Ponzi whereby investor "debentures" were sold, the proceeds of which were used to fund so-called merchant account loans, where loans were given to small businesses at high rates and the lender would "sweep" the borrower's credit card merchant accounts as the source of repayment. See SEC vs. 1 Global Capital LLC and Carl Ruderman, Case No 18-61991 (SDFL 2018). Next, in February, 2020, Brian Davison and Barry Rybicki were charged with a $170 million securities fraud in connection with their operation of a company known as Equialt LLC, which raised money from investors to fund purchases of commercial and residential real estate. See SEC vs. Brian Davison et al, Case 20-325 (MDFL 2020). And most recently, the SEC alleged that a convicted felon and his wife conducted a $500 million securities fraud by raising money through "Agent Funds" to fund small business loans

Woodbridge Group

From 2012 to 2017, Woodbridge Group, through a national network of unlicensed financial advisors, raised over $1.22 billion from over 10,000 investors nationwide to invest in commercial and residential real estate. Investors were promised 5-8% interest returns, based on loans that were purportedly made to third party borrowers at 11-15% for short term financing. Collateral for the loans was touted as high-grade real estate:[6]

Brochures and advertisements touted that investors would receive a "First Position Commercial Mortgage" as collateral for their investment.[7] The other key selling points were touted as:

- You receive 6% - 7% per year, paid monthly by direct deposit Your principal is returned in full at the end of the cycle.
- Easy to reapply your principal to another mortgage loan when your existing loan is paid off by the borrower.
- You are placed in First Position on all Commercial Mortgage Bridge Loans so your loans are fully secured with your name filed in the public land records.
- Timely interest payments of all interest and principal to you will be paid by the company assembling the deal. a Multi-Million Dollar Mortgage Fund
- Your principal never fluctuates in value and is unaffected by the gyrations of the stock or bond market
- You never pay any commissions. management fees or asset charges-100% of your money gets the full 6% - 7%.

[6] See Knowles System Brochure, Appendix 3.

[7] See Woodbridge Brochures, Appendix 4.

- Commercial Mortgage Bridge Loans can be purchased inside a self-directed IRA account.[8]

Even though Woodbridge raised over $1 billion from investors, it only generated $13.7 million from real estate borrowers that were unaffiliated with Woodbridge. [9] The reality was that the investors monies were not used to fund third party, arms distance, real estate loans. The loans were made to Robert Shapiro controlled companies, meaning that the left hand was loaning money to the right hand.[10] Some of the money was actually invested in real estate but hundreds of millions were simply acquired from new investors to pay back old investors. So, even though it generated no income beyond $13.7 million in interest from unaffiliated borrowers, Woodbridge managed to pay $368 million from new investor funds back to Woodbridge investors falsely branded as interest and principal returns earned from Woodbridge transactions.[11]

The marketing for these real estate products was slickly conceived. Excerpts from some of the brochures are shown below:

[8] See Appendix 4.

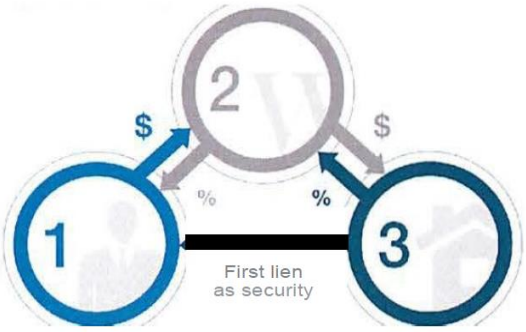
[9] See Complaint, DE1, at ¶2, SEC vs Shapiro, Case No. 17-24624 (SDFL 2017).

[10] See Beynon vs. Comerica, Bank, 18-00103 (CDCA 2018) DE 17 at ¶2.

[11] See Marsha Katz vs. Comerica Bank, Case No 17-62551 (SDFL 2017) DE1 at ¶2.

Now is the time to forego old-fashioned wealth-building solutions.

Woodbridge Wealth wants to help you diversify your portfolio by participating in the real estate revolution. What does that look like?



1 Private Lender

You lend money to Woodbridge for 1 year, and receive 5% monthly interest payments.

2 Woodbridge Wealth

Woodbridge funds the real estate property loan, and receives payments from the owner.

3 Real Estate Property

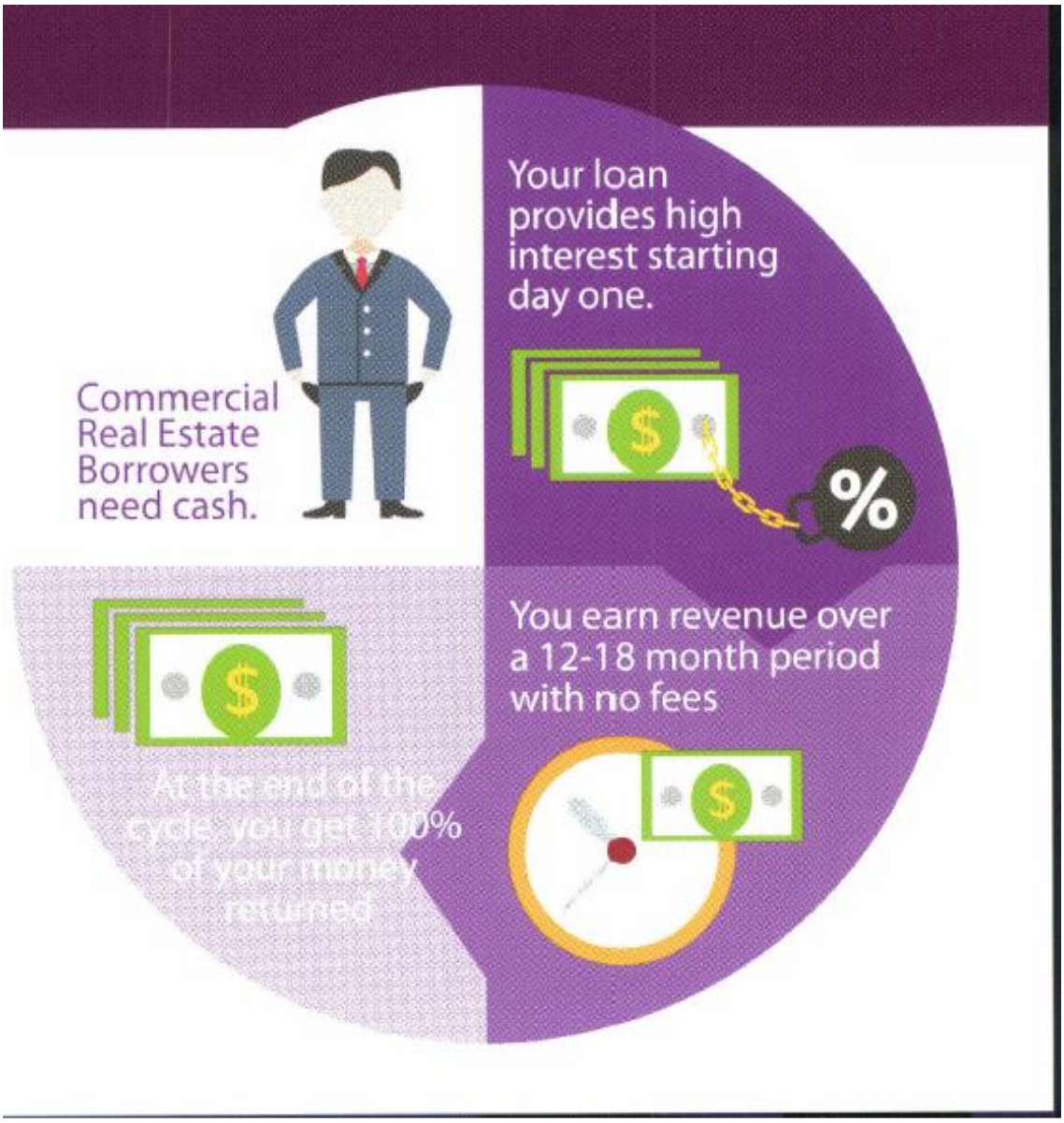
The property owner makes payments to Woodbridge and you receive the first lien position as a security.

Let us help you protect your retirement funds from market volatility. We succeed when you succeed. It's that simple.



A SOLID FINANCIAL PRODUCT:

- 6% for 12 months
- 7% for 18 months
- First position lien
- Interest paid each month and full principal returned at the end of the term
- These products can be purchased inside or outside of Self Directed IRA account


Commercial Real Estate Borrowers need cash.
Your loan provides high interest starting day one.
%
You earn revenue over a 12-18 month period with no fees
At the end of the cycle, you get 100% of your money returned

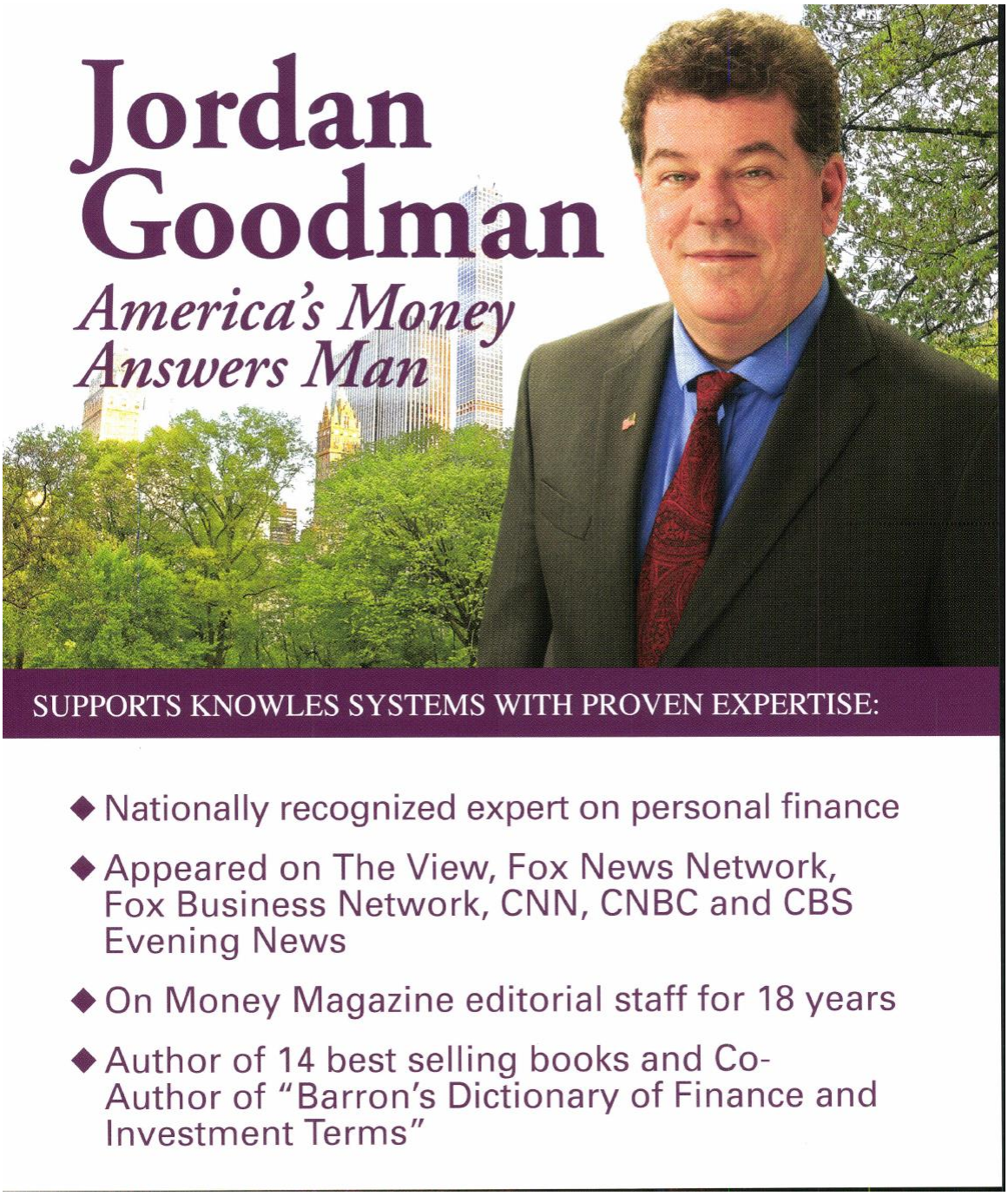
Commercial Mortgage Bridge Loans fund high quality real estate projects.



- You receive 6% - 7% per year, paid monthly by direct deposit. Your principal is returned in full at the end of the cycle.
- Easy to reapply your principal to another mortgage loan when your existing loan is paid off by the borrower.
- You are placed in First Position on all Commercial Mortgage Bridge Loans so your loans are fully secured with your name filed in the public land records.
- Timely interest payments of all interest and principal to you will be paid by the company assembling the deal, a Multi Million Dollar Mortgage Fund.
- Your principal never fluctuates in value and is unaffected by the gyrations of the stock or bond market.
- You never pay any commissions, management fees or asset charges—100% of your money gets the full 6% - 7%.
- Commercial Mortgage Bridge Loans can be purchased inside a self directed IRA account.

CALIFORNIA • COLORADO • FLORIDA • NEVADA • NEW YORK • RHODE ISLAND

These real estate investments were touted on national radio by Jordan Goodman.



One of the keys to raising money for Woodbridge was advertisign, both in print and on the radio. Jordan Goodman sold promoted Woodbridge on his radio show, where he was called "The Money Man.". Mr. Goodman touts himself as a nationally recognaized expert on personal financance and a frequent guest on The View, Fox News Network, Fox Business Network, CNN, CNBC and CBS. Mr. Goodman was on the Editorial Staff of Money Magazine and a wekkly financial analyst for NBC News. Interestingly, Mr. Goodman endorsed the Knowles Systems, the largest promoter of

Woodbridge Group real estate investments. Goodman appeared on AM radio around the country as a "guest" in shows ranging from approximately 5 to 30 minutes long.[12] He appeared on 850 KOA, Denver Colorado, 1120 KMOX, St. Louis, Missouri, 560 WHYN, Springfield, Massachusetts, and 720 WGN, Chicago, Illinois.[13] It was later revealed Goodman was paid $2.3 million in commissions for referring 1200 investors to the Knowles Systems, which raised $147 million from investors.[14]

Investors were given picture of the properties that collateralized their investments and "appraisals" to support the notion that the investments were well-collateralized. Importantly, these commercial real estate investments were allegedly backed by "first position commercial mortgages." In fact, there were two investment products sold to investors. The first was a five-year investment as a unit holder in Woodbridge Group affiliated funds ("Woodbridge Funds"). The Woodbridge Funds pooled investor money and purportedly made investments in various commercial loans. Unit holders were paid their return from a mix of loans held by the Woodbridge funds. The second investment was in the form of "promissory notes" allegedly backed by first position commercial mortgages. These promissory notes were typically 12 to 18-month terms paying 5-8% annual returns, with interest payments made monthly. Payments ceased around November, 2017, and one month later, Woodbridge Group filed for bankruptcy. *See generally, SEC vs. Robert H. Shapiro*, Case No 17-24626 (SDFL 2017).

The investment proceeds were not invested as promised, but in fact only a portion of the money raised was used to buy real estate, and about $400 million of the $1.22 billion raised was used to pay interest and principal payments straight back to investors in a Ponzi Scheme, while the promoters skimmed tens of millions of the top for themselves. Unlicensed financial advisors collected $64 million in commissions on the sale of Woodbridge Group investments. [15]

At the end of the day, the noteholders held about $700 million in unpaid notes and the unitholders were owed about $173 million in claims*. See Woodbridge Liquidation Trust, Amendment 1 to Form 10*, as filed with the SEC, December 13, 2019. Against these claims, the real estate that was purchased has a stated value of $333 million, or about 38 cents on the dollar, before future administrative expenses.[16]

The litigation fallout from the Woodbridge Group Ponzi has been extensive. For example, some PIABA members filed a class action against various unlicensed financial advisors in federal court. See Honig vs. Barry M. Kornfeld, Case No 18-80019 (MDFL 2018). The Second Amended Complaint alleged violations of the Florida Securities and Investor Protection Act for selling unregistered securities, and for sales by unlicensed persons as well as aiding and abetting fraud, and aiding and abetting breach of fiduciary duty. Id.[17] The motion for summary judgment alleged

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[12] SEC vs. Jordan Goodman, Case No. 18-25303 (SDF 2018) at DE1.

[13] Id at DE1.

[14] Id at DE1.

[15] See SEC Litigation Release 24020, December 21, 2017; *Woodbridge Liquidation Trust*, Amendment 1 to Form 10, as filed with the SEC, December 13, 2019.

[16] As of September 30, 2019; See Woodbridge Liquidation Trust, Amendment 1 to Form 10, as filed with the SEC, December 13, 2019 pg. F1.

[17] See Honig Second Amended Complaint, Appendix 5.

in part that each of the unlicensed promoters were liable in part because like many other states' securities acts, "Section 517.211 of the Florida Act renders jointly and severally liable "[e]ach person making the sale [of an unregistered security] and every director, officer, partner, or agent of or for the seller, if the director, officer, partner, or agent has personally participated or aided in making the sale." See e.g., Dillon vs. Axxys International Inc. 385 FSupp 1307 (MD 2005)[18]. While the motion for summary judgment was pending, the case was dismissed by stipulation of the parties, likely indicating of a settlement.[19]

Woodbridge Group investors also brought multiple class actions against Comerica Bank, first filed in Florida, and then in other states, ultimately being consolidated in California. See In re Woodbridge Group of Companies, LLC, Cas No 18-00103 (CDCA 2018).[20] That complaint alleged that Comerica bank was liable for the Woodbridge real estate Ponzi, in essence because it "aided and abetted" the scheme.

The principal allegations were that Comerica knew of the fraud and that it substantially assisted Robert Shapiro and Woodbridge to commit securities and real estate fraud. It has been alleged that Comerica, by following Bank Secrecy Act compliance and know your customer rules, learned the following:

A. Woodbridge's banking activity triggered *hundreds of internal alerts* on these sophisticated monitoring systems warning Comerica of suspicious activity in Woodbridge accounts. These alerts notified Comerica of banking activity in Woodbridge accounts associated with Ponzi schemes, money laundering, and bank fraud. Id at DE19 ¶4.
B. At least one alert triggered by Woodbridge was escalated to Comerica's President of Community Banks, who ordered that no further action be taken. Id. At ¶5.
C. The Texas Securities Commission notified Comerica that it had sanctioned Woodbridge. Comerica continued servicing the Woodbridge accounts. Even news of a pending SEC investigation of Woodbridge did not deter Comerica from continuing to accept investors funds and carry out transfer orders at Shapiro's direction. Id at ¶5.
D. Had Woodbridge operated a legitimate business, Comerica would have processed deposits of investor funds into accounts associated with discrete offerings, executed transfers from those accounts to make loans to borrowers and pay overhead expenses, received incoming payments of interest from borrowers, and processed checks drawn on the surplus to pay returns to investors. Id at ¶6.
E. Comerica instead received hundreds of large round number deposits of new investor funds; executed transfers comingling funds between and among separate Woodbridge affiliates; serviced "pass through" accounts, which began and ended each month with a similar balance but had tens of millions in interim activity; carried out large and numerous

[18] The Dillon Court said that "It must be shown that the defendant undertook "some activity in inducing the purchaser to invest...." Nichols v. Yandre, 9 So.2d 157, 160 (Fla. 1942). Inducement requires that the defendant "must actively and directly, rather than passively, derivatively, or by attribution or imputation, influence or induce the investor to buy." Dillon v. Axxsys Intl, Inc., 385 F. Supp. 2d 1307, 1311 (M.D. Fla. 2005); See also, Ruden v. Medalie, 294 So.2d 403 (Fla. Dist. Ct. App. 1974)(no secondary liability under the securities act based on a corporate secretary signing to attest to series of fraudulent corporate debentures. Id. at 405. The secretary did tell the investor that the issuer was a "great guy" but there was no discussion of the investor's investments. Id. at 406. The court affirmed the trial court's determination that this was insufficient as a matter of law to constitute inducement. Id.

[19] See DE247 and 253, See Honig vs. Barry M. Kornfeld, Case No 18-80019 (MDFL 2018).

[20] Jeff Sonn, Esq. of Sonn Law Group serves on the Executive Committee for Lead counsel in the Comerica class action.

transactions with attorney trust accounts; processed millions in transfers from investor accounts to Shapiro's spouse; facilitated the dissipation of millions in investor funds on luxury goods and private jet travel; and processed thousands of outgoing checks each month (each personally signed by Shapiro) to pay interest and principal to earlier investors.

F. Even when Comerica's automated systems were unable to accommodate Shapiro's banking orders, its staff manually approved checks Shapiro had written that otherwise would have bounced. Id at ¶6.

G. Around June 2013, Comerica gave Woodbridge access to a special commercial banking application that Comerica had "never provided . . . to any customers," according to the bank's Vice President for Information Security Architecture. Id at ¶68.

H. And on September 29, 2017, just days after Comerica received an SEC bulletin regarding a subpoena enforcement action against Woodbridge, Comerica personnel—including two vice presidents of AML compliance—emailed about negative news articles concerning Woodbridge. Id at ¶70.

I. Comerica knew that Woodbridge's operations were not consistent with its business model. Woodbridge's banking activity should have reflected its receipt of investor funds, use of those funds make loans to borrowers, receipt of interest payments from borrowers, and use of those funds to pay returns to investors. But that was not what Comerica saw. It saw a great deal of investor money entering Woodbridge accounts—and an array of other banking activities at odds with Woodbridge's claimed business model. Id at ¶75.

J. The transfer or commingling of funds among related accounts is a hallmark of a Ponzi scheme, particularly where that commingling fails to comport with a customer's business purpose. The FFIEC Examination Manual thus identifies as red flags "[u]nusual transfers of funds [that] occur among related accounts or among accounts that involve the same or related principals." Id at ¶78.

K. Shapiro pooled investor money in fund entity accounts at Comerica, then commingled them into a single Woodbridge operating account under his control. This commingling of funds among Woodbridge accounts occurred on a massive scale, and in contradiction of what Comerica knew to be Woodbridge's stated business model. Id at ¶79.

L. Comerica processed the incoming interest payments and accordingly knew that only a limited number of borrowers were making interest payments to Woodbridge. None of the Shapiro-affiliated entities that had received loans was paying any interest. Moreover, Comerica knew that the incoming interest payments to Woodbridge that it was processing did not come close to matching Woodbridge's committed outlays and purported business operations. Id at ¶84.

M. Instead of generating the substantial interest promised to investors, the loans generated only around $13.7 million from bona fide third-party borrowers. Id at ¶85.

N. The FFIEC BSA/AML Examination Manual identifies as red flags those "fund transfers [that] are sent in large, round dollar, hundred dollar, or thousand-dollar amounts." Id at ¶92. More than 99% of the more than $1.3 billion in transfers from investment fund accounts to operating accounts were made in round numbers that ended in "0.00," and averaged more than $550,000. More than 87% of the more than $220 million transferred back to the investment funds was also sent in round numbers averaging nearly $250,000. Id at ¶94.

O. Shapiro diverted investor funds to pay off approximately $9 million in credit card debt. Id at 106.

P. Although Woodbridge was a billion-dollar enterprise, Shapiro was the sole signatory for all Woodbridge bank accounts. And he insisted on hand-signing each and every check, whether to investors, sales agents, or others. These arrangements were highly unusual.

An investment concern of Woodbridge's size normally employs a management structure with multiple executives and account signatories. Id at ¶108

Q. Instead of retaining external auditors, Woodbridge relied on controller Nina Pedersen, who worked from her home in Florida and was not a certified public accountant. Id at ¶109.

R. A nationwide PACER search would have revealed that Robert Shapiro initiated voluntary chapter 7 bankruptcy proceedings in 1991. See In re Shapiro, 128 B.R. 328 (Bankr. E.D.N.Y. 1991). During those proceedings, Shapiro admitted to transferring money overseas to hide it from creditors. The same proceedings also revealed that Shapiro had several judgments entered against him, including a 1988 judgment in favor of European American Bank for $711,381; a 1990 judgment in favor of Coreast Bank for $303,090; and a 1990 judgment in favor of Bank Hapoalim for $481,027. Id at ¶135.

S. Comerica' fraud alert system flagged suspicious transactions in Woodbridge accounts, but took no action. Id at DE144. The notations of the analyst reviews were redacted from the consolidated class action complaint because it is considered proprietary information. See Consolidated Class Action Complaint at ¶119-182.

Comerica filed a motion to dismiss the investor class action. DE110. Comerica first argued that all of Plaintiff's claims were preempted by the Bank Secrecy Act (BSA). In re: Woodbridge Investments Litigation, 2020 WL 4529739 (CDCA 2020); Id at DE110. The preemption arguments rely on the safe harbor provision of the BSA that states in part:

> Any financial institution that makes a voluntary disclosure of any possible violation of law or regulation to a government agency or makes a disclosure pursuant to this subsection or any other authority, and any director, officer, employee, or agent of such institution who makes, or requires another to make any such disclosure, shall not be liable to any person under any law or regulation of the United States, any constitution, law, or regulation of any State or political subdivision of any State, or under any contract or other legally enforceable agreement (including any arbitration agreement), for such disclosure or for any failure to provide notice of such disclosure to the person who is the subject of such disclosure or any other person identified in the disclosure. 31 U.S.C. § 5318(g)(3)(A).

Courts have held that the safe harbor provision "explicitly preempts state law claims filed against financial institutions complying with its requirements." See, e.g., Stoutt v. Banco Popular de Puerto Rico, 158 F. Supp. 2d 167, 176 (D.P.R. 2001). Thus, the court held that the investors claims were preempted to the extent they relied on Comerica's failure to file a Suspicious Activity Report (SAR). Id at DE110. But the Court also ruled that to the extent that investors' claims go beyond conduct that Comerica failed to submit in an SAR, those claims are not preempted. Id.

The court next analyzed the aiding and abetting breach of fiduciary duty and fraud claims. To sustain an aiding and abetting claim, "[l]iability may . . . be imposed on one who aids and abets the commission of an intentional tort if the person (a) knows the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other to so act or (b) gives substantial assistance to the other in accomplishing a tortious result and the person's own conduct, separately considered, constitutes a breach of duty to the third person." Casey v. Bank Nat'l Ass'n, 127 Cal. App. 4th 1138, 1144 (2005) (quoting Sanders v. Superior Court, 27 Cal. App. 4th 832, 846 (1994)). Comerica argued that the investors failed the first prong, knowledge of the fraud, because knowledge has to be shown by more than just "red flags". See eg Lamm v. State Street Bank and Trust, 749 F.3d 938, 950 (11th Cir. 2014) ("Alleging that a bank disregarded 'red flags' such as 'atypical activities' on a customer's account is insufficient to establish knowledge.");

Lerner v. Fleet Bank, N.A., 459 F.3d 273, 294 (2d Cir. 2006) ("As discussed above, these 'red flags,' as alleged, were insufficient to establish a claim for aiding and abetting fraud because, although they may have put the banks on notice that some impropriety may have been taking place, those alleged facts do not create a strong inference of actual knowledge")).

But the Nineth Circuit has held that a bank's decision to ignore suspicious activity or red flags is sufficient to demonstrate actual knowledge. In re First All. Mortg. Co., 471 F.3d 977, 999 (9th Cir. 2006) ("That [the bank] came upon red flags which were seemingly ignored was enough to establish actual knowledge under the California aiding and abetting standard . . . ."). The Woodbridge court, in analyzing the allegations, found the investors plead more than just "red flags," : "Plaintiffs do not rely solely on the fact that Comerica purportedly ignored red flags of which it was aware. They set out detailed allegations pertaining to, for example, the closeness of Comerica's relationship with Shapiro and the purportedly obvious flaws in Woodbridge's business model. These allegations, on top of those relating to the red flags that Comerica allegedly ignored, are sufficient to state a claim for aiding and abetting fraud and breach of fiduciary duty." Id. DE110.

The Court next analyzed the negligence claim. Normally, banks owe no duty to noncustomers. Casey, 127 Cal. App. 4th at 1149; Evans v. ZB, N.A., 779 Fed. Appx. 443, 444 (9th Cir. 2019). But there is an exception to the rule, for example where an individual "attempts to deposit a check bearing objective signals of fraud and the individual is not the check's payee." See Sun 'n Sand, Inc. v. United California Bank, 21 Cal. 3d 671, 693–96 (1978). "The court in Sun 'n Sand found that the bank owed the non-customer plaintiff a duty of inquiry, but noted that the bank's obligation was still minimal." Id. at 695. But the court in Woodbridge found that the investors failed to allege the existence of any signals of fraud on a check where someone attempted to deposit the check was not the payee, so it dismissed the negligence claim. Id at DE110.

The last claim the court analyzed was California's Unfair Competition Law (UCL). Section 17200 of the California Business & Professions Code (BPC) defines "unfair competition" in three ways:

> "Unlawful, unfair or fraudulent business act[s] or practice[s]";
> "Unfair, deceptive, untrue or misleading advertising"; and
> Violations of the provisions of California law starting at § 17500 of the BPC.
> Most any "person," defined to include most business entities, may be sued under the UCL by investors. Courts have interpreted the term "business act or practice " to cover most business-related activities, including ongoing conduct and isolated actions.

Comerica first attacked the investors' standing to bring a UCL claim, alleging that the investors could not show that the practices it characterized as unlawful was the cause of an actual injury. In re: Woodbridge Investments Litigation, 2020 WL 4529739 (CDCA 2020); Id at DE110. The Court, however, found that the complaint sufficiently alleged the investors' causation theory, because the investors alleged that Comerica affirmatively facilitated Woodbridge's "misappropriation of funds, and failed to stop maintaining Woodbridge's accounts when it had actual knowledge of the fraud." Id. Moreover, the investors alleged that had Comerica stopped the transactions, or stopped servicing the accounts, Woodbridge would have been unable to continue the fraudulent operations that hurt them. Id. The Court, however, made it clear that the UCL claims could not rely on any claims that are related to any SAR conduct. Id.

This Woodbridge decision is very significant. Often, courts dismiss allegations of aiding and abetting investor fraud, finding that the knowledge of the bank was merely red flags, insufficient to sustain a case. See Honig v. Kornfeld, 339 F. Supp. 3d 1323, 1343-44 (S.D. Fla. 2018) ("Florida law requires that a defendant have actual 'knowledge of the underlying fraud or breach of fiduciary

duty,' not merely that certain 'red flags' indicate a defendant 'should have known' of the breach." (quoting Lamm v. State Street Bank & Trust, 749 F.3d 938, 950 (11th Cir. 2014))); Wiand, 938 F. Supp. 2d at 1244 (citing Aetna Cas. & Sur. Co. v. Leahey Constr. Co., Inc., 219 F.3d 519, 536 (6th Cir. 2000) ("[E]vidence establishing negligence, i.e., that a [secondary wrongdoer] 'should have known,' will not suffice.")); Obeid vs. La mack 2019 WL 2209160(SDNY 2019)(alleged breaches simply demonstrated that there were red flags, which are, at best, indicative of only constructive knowledge).

Equialt LLC

Another recent real estate fraud involved residential real estate. In February, 2020, in SEC vs. Equialt LLC, the SEC obtained a Temporary Restraining Order, after alleging that Equialt raised $170 million from investors to invest in residential real estate, but in fact only invested some of the money, while the promoters siphoned off $60 million for their own use. See Complaint, SEC vs. Brian Davison, Case No 20-cv-235 (MDFL 2020). It was alleged the Equailt used money from one Fund to pay investors in another Equialt affiliated fund; paid substantial undisclosed commissions to unregistered sales agents; pad substantial undisclosed due diligence fees, management fees, success fees, auction fees, underwriting fees, purchase discount fees, and bonuses to the two principals, Brian Davison and Barry Rybicki. Id at DE1 ¶5.

Equialt's business model appeared plausible to investors. Equialt would raise money from investors, and buy single family homes and small multiunit properties, while maintaining "no debt." See Appendix 6, Equialt Marketing Brochure. Equialt also claimed it would buy assets far under market value, rehabilitate the property, typically make it cash flow within 28 days, on average. Id. Equialt also claimed to use a conservative purchase to value ratio of 70% of what Equialt felt was the true market value. Id. Equialt claimed it would obtain these properties via tax certificated; trustee sales, and bank foreclosures. Id.

Equialt began around 2012. But by 2013, the Arizona division of securities began an investigation. At one point, one of the unlicensed salespersons became concerned, because he was told by an investor that according to an Arizona investigator, unless each investor received their own trust deed for the property, then it was likely an investment sold in violation of the securities laws. See Gleinn vs. Wassgren, DE13 at ¶101. Case No. 20-1677 (MDFL 2020). For reasons unknown, the Arizona division of securities never followed up on their 2013 investigation, until after the SEC brought its action in 2020. In 2020, the Arizona division of securities has filed a case against the very unlicensed financial advisor it began investigating in 2013. See in the matter of Ronald F. Stevenson et al, Case. S-21110A-20-0190.

As a result of the Equialt fraud, investors first brought a class action against all the unlicensed financial advisors for being unlicensed, and for selling unregistered securities. See Rubinstein vs. Equialt, Case No. 20-0448 (MDFL 2020). But, in an unexpected move, the Receiver for Equialt decided to oppose the investors' claims, stating that he felt it would "affect the property of the corporate defendants and relief defendants." Id at DE26. After discovering that the insurance companies were denying coverage for the financial advisors, and that the Receiver was opposing the investors from asserting their claims, the investors reached tolling agreements with the advisors and dismissed the case without prejudice. But, not before learning that there was evidence that Equialt's attorney had knowledge of the sale of unregistered securities by unlicensed agents.

Hence, the investors sued Equialt's attorneys for aiding and abetting fraud and aiding and abetting breach of fiduciary duty and fraud, in addition to various state securities laws violations. See

Gleinn vs. Wassgren, Case No 20-01677 (MDFL 2020). In that complaint, the investors charged that Wassgren and his law firms were jointly and severally liable for aiding and abetting the Equialt Ponzi scheme. Again, the Receiver opposed the investors' rights to bring an action against any third party, including the attorneys, and rebuffed all efforts by the investors' attorneys to cooperate with the Receiver. While the disagreement between the investors and Burt Wiand, the Receiver, was ongoing, the Eleventh Circuit issued a very important ruling favoring investors, Isaiah vs. JP Morgan Chase, 960 F3d 1296 (11th Cir. 2020). In Isaiah, the Eleventh Circuit affirmed that the investors solely own aiding and abetting claims against third parties where the Ponzi scheme entity had no innocent officer or director:

> As in Freeman, ***any claims for aiding and abetting the torts of the Receivership Entities' corporate insiders belong to the investors who suffered losses from this Ponzi scheme, not the Receivership Entities***. The Receivership Entities thus cannot assert tort claims against third parties like JPMC for aiding and abetting *1308 the Ponzi scheme. Because Isaiah, as receiver, stands in the shoes of the Receivership Entities, he too lacks standing to bring these aiding and abetting claims against JPMC…
>
> [We] hold that Isaiah [the Receiver] ***lacks standing to assert, on behalf of the Receivership Entities, claims against JPMC for allegedly aiding and abetting the Ponzi schemers' breach of fiduciary duties, conversion, and fraud.*** Like in Freeman, Isaiah's ability to pursue these claims is barred not by the doctrine of in pari delicto, but by the fact that the Receivership Entities were controlled exclusively by persons engaging in and benefitting from the Ponzi scheme, and so the Receivership Entities were not injured by that scheme. 865 So. 2d at 550–51. ***In the absence of any allegation in the complaint that the Receivership Entities had at least one innocent officer or director and were thus honest corporations injured by the actions of a few corrupt employees, the Receivership Entities—and in turn, Isaiah—lack standing to pursue claims against JPMC for aiding and abetting the Ponzi scheme.***
>
> * * *
>
> While collecting damages from third parties may indirectly benefit the defrauded investors and other creditors of the Receivership Entities—e.g., by enlarging the "pie" from which the creditors may ultimately recover—***the receiver does not pursue such actions on behalf of the creditors because he does not represent those creditors***… ***To allow receivers to bring these types of lawsuits purportedly for the benefit of the entities' creditors is really to usurp the claims that properly belong to those creditors***. And while the receiver continues to litigate these claims in his own suit, the statute of limitations may be running on those claims that the creditors actually possess and for which, if enough time has passed, they may lose the ability to recover. [emphasis added]

See Isaiah vs. JP Morgan Chase, 960 F3d 1296, 1306-08 (11th Cir. 2020).

The Isaiah ruling was issued June 1, 2020. The Equialt court held a hearing on the SEC's Motion for Entry of a Permanent Injunction on July 31, 2020. During that hearing, Judge Scriven heard a motion on the investors motion "to confirm their unimpeded right to prosecute" their claims against the attorneys for Equialt for aiding and abetting. After hearing argument, the Court ruled that the investor's claims did not violate the court's injunction, and that the court said,

> "Well, the short answer to your question is that to the extent that the Eleventh Circuit has said investors have the right to prosecute those claims, I'm not empowered to overrule that right, and so what I think the answer is is that the motion to confirm that you have the right to prosecute your claims should be granted, and then the question that will follow in the lawsuit that's now been transferred from Judge Covington to me, I think, will be whether you own the claims that you are asserting, and that will be brought typically on an answer or on a motion to dismiss that suit. SEC vs, Davison et al Case 10-cv-00325 (transcript, July 31, 2020.)

The investors in Equialt have sued Equialt's attorneys, alleging that they aided and abetted the breach of a fiduciary duty and fraud, in part, for actions outside the normal role of an attorney. Gleinn vs. Wassgren, Case No 20-01677 (MDFL 2020). Typically, attorneys are not liable for providing routine legal services. See e.g. Zazzlai v. Hirschler Fleisher 482 BR 495 (DDE 2012); *Meridian Horizon Fund, LP v. KPMG (Cayman),* 487 Fed.Appx. 636, 643 (2d Cir.2012). *See also Schatz v. Rosenberg,* 943 F.2d 485, 497 (4th Cir.1997) (no aiding and abetting liability when law firm merely "papered the deal" or acted as a scrivener); *Chem–Age Indus., Inc. v. Glover,* ****504*** 652 N.W.2d 756, 774–75 (S.D.2002) (same). If the law did not protect routine legal services, one could argue that it would be nearly impossible for an attorney, no matter how honest, to avoid liability for a client's fraud. See, e.g., Witzman v. Lehrman, Lehrman & Flom, 601 N.W.2d 179, 189 (Minn.1999)(analyzing routine services of an accountant).

But some states dissent from this rule. California courts, for example, have found that ordinary transactions can constitute "substantial" assistance if the aider and abettor knew the services would help their client commit the tort. Casey v. U.S. National Bank Ass'n, 127 Cal.App.4th 1138, 26 Cal.Rptr.3d 401, 406 (2005). So, "[i]f an attorney participates in independently fraudulent activities, his action is 'foreign to the duties of an attorney,' " and he can therefore be sued by third-parties. Alpert v. Crain, Caton & James, P.C., 178 S.W.3d 398, 406 (Tex. App.—Houston [1st Dist.] 2005, pet. denied); see also Santiago v. Mackie Wolf Zientz & Mann, P.C., 2014 WL 4072131, at *3 (Tex. App.—Dallas 2014, pet. filed) ("Thus, if the only ground for summary judgment is attorney immunity, and the plaintiff alleges claims that could arguably involve fraudulent conduct, the trial court should deny a motion for summary judgment based on attorney immunity as to those claims."). In some situations, attorneys may also be held liable for lying on a client's behalf, Chu v. Hong, 249 S.W.3d 441, 446 (Tex. 2008), or for malicious activity, Likeover v. Sunflower Terrace II, Ltd., 696 S.W.2d 468, 472 (Tex. App.—Houston [1st Dist.] 1985, no writ).

In Gleinn vs. Equialt, the investors allege that Equialt's attorneys had both knowledge and provided substantial assistance to the Equialt fraud. First, Equialt's attorneys (Paul Wassgren and his partner) were told, in writing, that the Arizona securities regulators believed that absent a trust deed issued to each investor, there were likely violations of the securities laws. Second, Wassgren, the attorney, drafted the SEC form Ds, and if one were to add up all the disclosed nonaccredited investors, it exceeded 35, meaning that Equialt violated the very exemption it was claiming from the securities laws. But Wassgren hid this fact by creating multiple offerings, even though all the money was used for one, consolidated ongoing operation.

Third, Wassgren drafted "finder's agreements" to allow the unlicensed financial advisors to sell the private placement investments without a license. Any attorney practicing securities laws knows that "finder's agreements" are typically not used for transaction-based compensation, and even then, are usually only meant for one-off circumstances, and cannot be used in ongoing securities offerings. For example, in the matter of John R. Wirthlin, the SEC refused to issue a no-action letter, in part, because Wirthlin would "receive transaction-based compensation, one of

the hallmarks of being a broker-dealer." See John R. Wirthlin, SEC No-Action Letter (January 19, 1999); Indus Partners, LLC v. Intelligroup, Inc., 77 Mass.App.Ct. 793, 798–800 (2010). Wirthlin wanted to contact certain professionals such as accountants or real estate brokers who may have clients interested in investing in a real estate limited partnership. Wirthlin then would introduce potential investors to a representative of the issuer. It was proposed that Wirthlin would have no other or further involvement after the introduction and would never even meet the investors. The SEC declined to issue the no action letter. Id.

Another consideration is whether the finder participates in negotiations. The SEC summarized their view in IMF Corp., SEC No-Action Letter (May 15, 1978) where it indicated that:

> "Individuals who do nothing more than act as finders by bringing together merger or acquisition-minded persons or entities and who do not participate in subsequent negotiations probably are not brokers or dealers in securities and would not be required to register with the Commission. On the other hand, persons who play an integral role in negotiating and effecting mergers or acquisitions that involve transactions in securities generally are deemed either a broker or a dealer depending upon their particular activities, and are required to register with the Commission pursuant to Section 15(a)."

See also Gary L. Pleger, Esq., SEC No-Action Letter (October 11, 1977) and Corporate Forum, Inc., SEC No-Action Letter (December 10, 1972).

In Gleinn vs. Wassgren, it was alleged that the unlicensed advisors, who were provided the "finder's agreements" were receiving transaction based commissions, and were negotiating the investments for the issuer, Equialt. Complaint. DE 13 at ¶47,¶85. Further, it was alleged that Wassgren stepped outside his role as a routine legal advisor, because the principal of Equialt, Barry Davison, testified that Wassgren was integral to building all of his companies, helping him develop the concept of raising money through private placements and created the Private Placement Memoranda with false statements. Wassgren even permitted his name and his law firm names to be printed on Equialt Brochures. See Amended Complaint, Gleinn vs. Wassgren at ¶46.

In defending his actions, even Barry Rybicki, who oversaw all the sales by all the financial advisors, pointed to Wassgren as integral to Equialt's business operations:

> Mr. Davison and Mr. Wassgren … drafted and had authority over the PPMs. EquiAlt retained the services of Paul Wassgren in virtually all aspects of EquiAlt's business operations and entrusted him with ensuring EquiAlt complied with securities laws … Mr. Wassgren prepared EquiAlt's marketing materials to investors aware of the purpose for which these materials would be disseminated and used, vetted and participated in approving EquiAlt's PPMs; and provided legal advice to EquiAlt as to the legality of paying commissions to unregistered sales agents for the sale of debentures. … Mr. Rybicki directed sales agents to speak with Mr. Wassgren when they had questions regarding the legal requirements for selling EquiAlt Funds.

See SEC vs. Davison, [ECF No. 152 at 19–20]

The investors charged that Wassgren should be held liable under several states securities laws for participating or materially aiding in the sale of the securities. While Florida interprets the

"personally participated or aided in making the sale" language as requiring someone to "induce" the sale, other states only require proof that the agent provided "material aid," without proof of inducing the sale. See e.g. Oregon Securities Act ORS § 59.115(3); Prince v. Brydon, 307 Or. 146 (1988). So, Oregon courts have found that "" '[p]articipate' and 'materially aid' are separate concepts, not synonyms." Prince v. Brydon, 307 Or. 146, 149 (1988).[21] In Prince, an attorney was sued for "preparing documents and performing other legal services for the partnership." The legal issue was whether he could be held liable under the securities act as one who "participate[d]" or materially aid[ed]" in the unlawful sale of the security under ORS 59.115(3)-- unless he established a lack of knowledge as a defense. Id. The trial court granted summary judgment for the attorney, and the appeals affirmed. Prince v. Brydon, 89 Or.App. 203, 748 P.2d 158 (1988). The Oregon Supreme Court reversed and remanded the case for further proceedings, finding that "the defense against strict liability, in short, was to be a showing of ignorance, not the professional role of the person who renders material aid in the unlawful sale." Id.

The Alabama securities act views "material aid" a little differently. First, Alabama law does not define the phrase an "agent who materially aids" in the sale of securities. See ALA.CODE § 8–6–19(c). The Alabama securities act does define "agent" as "any individual other than a dealer who represents a dealer or issuer in effecting or attempting to effect sales of securities...." ALA.CODE § 8–6–2(2). The Alabama Supreme Court has said that the phrase "materially aids" extends "liability to groups of persons beyond the [actual] seller of the security." Foster v. Jessup and Lamont Securities Co., Inc., 482 So.2d 1201, 1206 (Ala.1986) (answering a certified question from the Eleventh Circuit). And, in Foster, the court held that the test for "materially aiding" in the sale of securities is less strict than whether the entity was a "substantial factor" in the sale of such securities. Id. at 1207. But, despite those two pronouncements, the Alabama Supreme Court did not make a bright line rule, simply finding that under the facts of the case before it, the "jury was justified" to find the broker, Jesup & Lemont, materially aided the sale to the investor and thus violated Alabama statute § 8–6–19. Id. at 1207–08.

In Oregon, courts have found that the securities act may be applied to an attorney where ""[a] lawyer who prepares the legal documents necessary for the creation of the entity whose securities are sold, prepares the offering statement for that sale or gives an opinion on the entity's tax status—all of which are routine parts of a securities practice—has materially aided in the sale. Without those actions, a sale cannot occur." Prince v. Brydon, 307 Or. 146, 149 (1988). "Generally, participation addresses direct involvement in the sale, while material aid involves indirect support for the seller in making the sale." Id. at 150 (drafting partnership documents and providing legal advice regarding private securities offering was material aid); Adams v. Am. W. Secs., Inc., 265 Or. 514, 527 (1973) (preparing sales documents for use in transaction was participation); Ainslie v. Spolyar, 144 Or. App. 134, 145 (1996) ("Ainslie I") (preventing a foreclosure and providing legal services prior to an offering was material aid). But other decisions use the terms together ("participate or materially aid"), without distinction. See, e.g., Fakhrdai v.

[21] Only primary actors are subject to civil liability for damages under federal securities laws. Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A. (1994) 511 U.S. 164, 179, 114 S.Ct. 1439, 128 L.Ed.2d 119 (Central Bank) [holding no secondary liability under § 10(b) of the Act]. But, the Supreme Court in Central Bank did say: "The absence of ... aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator ..., assuming all of the requirements for primary liability ... are met. .... In any complex securities fraud ... there are likely to be multiple violators...." (Central Bank, supra, 511 U.S. at p. 191, 114 S.Ct. 1439; see In re Enron Corp. Securities, Derivative & ERISA Litigation (S.D.Tex.2002) 235 F.Supp.2d 549, 582.)

Mason, 72 Or. App. 681, 684 (1985); Ainslie v. First Interstate Bank of Or., N.A., 148 Or. App. 162, 184–85 (1997) ("Ainslie II"). Whether assistance in the sale is "material" is not dependent on one's knowledge of the facts that make it unlawful; "it depends on the importance of one's personal contribution to the transaction." Prince v. Brydon, Mercer v. Jaffe, Snider, Raitt & Heuer, P.C., 713 F.Supp. 1019, 1028 (W.D.Mich.1989). The Mercer court held that, in order to be liable under MICH. COMP. LAWS § 451.810(a), the buyer must believe that he or she purchased the securities from the defendant. Id. Because the defendant-lawyers in Mercer only "prepared promotional material or offering statements" they could not be held liable because "[t]he buyer does not in any meaningful sense 'purchase the security from such a person." Id. at 1024.

Real estate investment scams have become more prevalent in recent years. Attorneys for investors are well-advised to become more familiar with remedies that can help recover money for harmed investors.

RECOVERING PROCEEDS OF LIFE INSURANCE POLICIES BOUGHT WITH FRAUDULENT OR ILL-GOTTEN FUNDS[22]

Imagine you represent a plaintiff or group of plaintiffs who invested in what turns out to be a fraudulent enterprise, but the principal bad actor of such enterprise has died. As it turns out, the principal has limited assets, and many creditors. During his life, the now-deceased principal used monies from the fraud to purchase a term life insurance policy, the beneficiary of which is his spouse, children, or other third-party not affiliated in any way with the principal's fraud or misdeeds. Unfortunately, most states have enacted statutes that protect the beneficiaries of Term life insurance policies from creditors of the dead principal-insured or the principal-insured's estate.

This article will explore two equitable remedies that a plaintiff can utilize to recover the life insurance proceeds in instances where the plaintiff can establish that monies utilized to purchase the policy were connected to the principal-insured's fraud. The first remedy is a constructive trust; the second is commonly referred to as an equitable lien. The constructive trust is ideally established over the monies before they are paid out to the beneficiary of the estate, usually at the stage where proceeds are held by the insurance company or interpled into the court registry.

Constructive Trust

Where a person wrongfully takes for himself or herself assets of another, a court may impose a constructive trust on any property subsequently obtained with the ill-gotten funds, so long as it can be demonstrated that the funds are traceable to the victim's original assets. *See Finkelstein v Se. Bank, N.A*., 490 So. 2d 976, 983 (Fla. 4th DCA 1986); *ITT Commodity Development Corp. v. Barton*, 457 F. Supp. 224, 230 (M.D. Fla. 1978) (*citing Quinn v. Phipps*, 113 So. 419 (Fla. 1927)) ("The Florida Supreme Court has also stated that equity will raise a constructive trust and compel restoration where one, through actual fraud, abuse of confidence reposed and accepted, or through other questionable means, gains something for himself which in equity and good conscience he should not be permitted to hold.").

To trace the funds, the party seeking to impose a constructive trust on life insurance proceeds need only demonstrate that (1) there existed ill-gotten funds; (2) such funds were deposited in a particular account; and (3) the policy premiums were paid out of a particular account. *See Paschal v. Great W. Drilling, Ltd*., 215 S.W. 3d 437, 444-45 (Tex. Ct. App. 2006) (citing *Marineau v. Gen.*

[22] By James Sallah, Sallah, Astarita and Cox LLC.

Am. Life Ins. Co., 898 S.W. 2d 397, 400 (Tex. Ct. App. 1996)); *Lackey v. Lackey*, 691 So. 2d 990, 993 (Miss. 1997). Proper tracing does not require a dollar-for-dollar accounting, but rather, "equity will follow a fund through any number of transmutations, and preserve it for the owner as long as it can be identified." *In re Int'l Admin. Servs., Inc*., 408 F.3d 689, 708-09 (11th Cir. 2005) (citations omitted). Accordingly, the burden may be satisfied by merely showing that the tainted funds were deposited into an account subsequently used to pay insurance premiums.

When stolen funds are shown to have been commingled in an account with legitimate funds, the law presumes the policy was paid for with stolen fuds, and the burden shifts to the beneficiary to prove otherwise. *See Marineau*, 898 S.W.2d at 403; *Succession of Onorato*, 51 So. 2d 804, 814 (La. 1951); *Lackey*, 691 So. 2d at 993 (concluding that the better reasoned approach" is to put the burden on proving that premiums were not paid for out of the portion of the funds in the commingled account which were misappropriated from the trust) (emphasis in original). Unless the beneficiary of the life insurance policy can show be "full, clear, and strict proof" that the policy's premiums were paid with separate funds, the presumption will prevail. *See Thomas v. Burke*, 200 So. 69, 70 (Fla. 1941). Essentially, once the plaintiff establishes that the fraudster commingled funds, the burden shifts to the beneficiary to prove that the premiums paid were not, in fact, tainted.

Innocent Third Parties

There is authority extending a plaintiff's ability to recover proceeds from innocent third parties who are beneficiaries of the insurance policy that was procured by utilizing tainted funds. *See, e.g., Fed. Ins. Co. v. Smith*, 63 Fed. Appx. 630, 633 (4th Cir. 2003) ("Many states allow the wronged party to recover life insurance proceeds from the beneficiary when the policy premiums were paid with embezzled funds, usually by imposing a resulting or constructive trust on the life insurance proceeds.") *Brown v. NY Life Ins. Co*., 152 F. 2d 246, 250 (9th Cir. 1945) ("even the widow of a trustee ex maleficio who has pad no consideration for the property purchased with misappropriated funds, or for their fruits, many not hold such property, or the fruits thereof, against the cestui que trust, who is the real owner."); *Tex. Life Ins. Co. v. Morgan,* No. 3-86-0846, 1987 WL 44392, *3 n.7 (N.D. Tex. Oct. 19, 1987) ("Where the choice is between whether the aggrieved party or the beneficiary will receive the windfall, public policy would tip the scales in favor of the aggrieved party."). As the *Morgan* court eloquently explained:

> If the beneficiaries were able to recover on the policy, this would allow the wrongdoer to have achieved his purpose and benefit from the fraudulent conduct. Of course, if a portion of the policy were paid for with legitimate funds, the beneficiaries would be entitled to that proportionate share of the proceeds.

Morgan, 1987 WL 44392, at n. 7. In other words, the majority view dictates that the defrauded party recover that percentage of the proceeds in congruity with the percentage of the premiums paid for with tainted funds. The law is designed to disincentivize such egregious behavior as that displayed by the wrongdoing and does not necessarily to take into account the purported innocence of the beneficiary. Therefore if the beneficiary cannot satisfy his or her burden, the law presumes that 100% of the premiums were paid for with the tainted funds. Thus, 100% of the proceeds would be subject to claims by the defrauded party and to a constructive truest.

A 1942 California court applied this such extension of the law, noting that:

> Although there seems to be no case directly in point in this state, there is a line of authorities in other states to the effect that where a person has embezzled funds and used them for the payment of premiums for insurance on his life, a trust is created in favor of the person from whom they were embezzled, and that **such person is entitled to such proportion of the total insurance as the amount of premiums which have been paid from the embezzled funds bears to the total amount of the premiums paid.**
>
> ********
>
> There is some authority that the defrauded person is limited to recovering the amount of the premiums paid with the misappropriated funds…**the better reasoned cases permit a pro tanto recovery.**

Brodie v. Barnes, 56 Cal.App.2d 315, 323 (1942) (citations omitted) (emphasis added). While the *Brodie* opinion cites to *Mathis* as an example of a case limiting recovery to the amount of premiums paid, in 2009, the *Waxenberg* court in the Middle District of Florida explained that *Mathis'* holding, besides being over seventy years old, also did not stand so strongly against the recovery of more than the amount of the paid in premiums. *See New York Life Ins. Co. v. Waxenberg*, No. 8:07-cv-401-T-27TGW, 2009 WL 632896, *8 (M.D. Fla. Mar. 11, 2009) (*citing Bd. Of Pub. Instruction for Bay County v. Mathis*, 181 S. 147 (Fla. 1938)) ("the Court finds that the Receiver could reasonably argue for an extension of the holding, particularly because *Mathis* did not expressly preclude recovery of a pro rata share.")

Equitable Remedies in the Context of the Florida Statute Protecting Life Insurance Beneficiaries from Creditors

The law of many states, including Florida, include a provision that protects the beneficiary of a life insurance policy from the creditors of the insured's estate, with limited exceptions. Florida Statutes §222.13, provides:

> 222.13 Life insurance policies; disposition of proceeds.
>
> (1) Whenever any person residing in the state shall die leaving insurance on his or her life, the said insurance shall inure exclusively to the benefit of the person for whose use and benefit such insurance is designated in the policy, and the proceeds there shall be exempt from the claims of creditors of the insured unless the insurance policy or a valid assignment thereof provides otherwise. Notwithstanding the foregoing, whenever the insurance, by designation or otherwise, is payable to the insured or to the insured's estate or to his or her executors, administrators, or assigns, the insurance proceeds shall become a part of the insured's estate for all purposes and shall be administered by the personal representative of the of the insured in accordance with the probate laws of the state in like manner as other assets of the insured's estate.

Notwithstanding the statutory protections provided to beneficiaries of insurance policies under §222.13, following the reasoning of *Finkelstein*, *Barton*, and *Quinn*, the imposition of a constructive trust would be appropriate in an instance where the proceeds earmarked for the beneficiary flowed from an insurance policy procured with tainted funds. Ideally, the plaintiff

seeking the constructive trust would need to seek such relief prior to the funds being paid to the beneficiary of the policy.

Equitable Lien

If life insurance proceeds have already been paid out to, and are in the possession of, a beneficiary, a plaintiff should attempt to establish an equitable lien over the proceeds. An equitable lien is "a right granted by a court of equity, arising by reason of the conduct of the parties affected, which would entitle one party as a matter of equity to proceed against certain property." *Tribeca Lending Corporation v. Real Estate Depot, Inc*., 42 So. 3d 258, 262 (4th DCA 2010). Equitable liens may be based upon considerations of estoppel and unjust enrichment. As an equitable remedy, the plaintiff must also establish that it is innocent or has clean hands. *Id*.

At least one Florida federal court has imposed an equitable lien on the proceeds of a policy which was purchased with funds obtained through fraud. In *New York Life Insurance Company v. Waxenberg*, 2009 WL 32896 (M.D. Fla. 2009), the court stated:

> [The defendant] also argues that the Receiver had no legal basis for pursuing the life insurance proceeds…[because] Fla. Stat. §222.13 exempts life insurance proceeds from the claims of creditors… This [argument] is without merit. Fla Stat. §222.13 provides that life insurance shall inure exclusively to the benefit of the person for whose use and benefit such insurance is designated in the policy, and the proceeds thereof shall be exempt from creditors." Fla Stat. §222.13(1). Notwithstanding the application of §222.13, the Florida Supreme Court has specifically allowed for the recovery of life insurance policies paid with fraudulently transferred funds. *See Bd. Of Pub. Instruction for Bay County v. Mathis*, 132 Fla. 289, 181 So. 147, 149 (Fla. 1938). Other jurisdictions have noted that similar statutes do not apply to life insurance policies paid for with fraudulently transferred funds.

More importantly, however, is that Florida statutes themselves specifically make Fla. Stat. §222.13 inapplicable where fraud is involved. Section 222.29 expressly provides "[a]n exemption from attachment, garnishment, or legal process provided by this chapter is not effective if it results from a fraudulent transfer or conveyance as provided in chapter 726." Accordingly, when stolen or fraudulently obtained monies are transferred to an insurance company for the purposes of paying premiums, such constitutes a fraudulent transfer under Fla. Stat. §222.13.

Further, under Florida law, the imposition of an equitable lien on proceeds from an insurance policy procured with fraudulent funds is supported by Fla. Stat. §222.30. This statute provides that "[a]ny conversion by a debtor of an asset that results in the proceeds of the asset being exempt by law from the claims of a creditor of the debtor is a fraudulent asset conversion as to the creditor…if the debtor made the conversion with the intent to hinder, delay, or defraud the creditor." Importantly, Fla. State. §222.30 further provides, in relevant part, "[i]f a creditor has obtained a judgment on a claim against the debtor, the creditor, if the court so orders, may levy execution of the asset converted or *its proceeds*." Fla. Stat. §222.30(4)(emphasis added). Thus, this statute allows for the recovery of the proceeds of the policies.

Not All States Allow Plaintiffs to Reach Life Insurance Proceeds

Not all states allow plaintiffs to recover life insurance proceeds notwithstanding the fact the policy may have been purchased with funds obtained through fraudulent means. Georgia is an example. Georgia Statute §33-25-11(a) provides:

> Whenever any person residing in the state shall die leaving insurance on his or her life, such insurance shall inure exclusively to the benefit of the person for whose use and benefit such insurance is designated in the policy, and the proceeds thereof shall be exempt from the claims of creditors of the insured unless the insurance policy or a valid assignment thereof provides otherwise. Whenever the insurance, by designation or otherwise, is payable to the insured or to the insured's estate or to his or her executors, administrators, or assigns, the insurance proceeds shall become a part of the insured's estate for all purposes and shall be administered by the personal representative of the estate of the insured in accordance with the probate laws of the state in like manner as other assets of the insured's estate.

While the language of OGA §33-25-11 is similar to Florida Statute §222.13, the case law in Georgia has not been favorable to victims of fraud in actions against life insurance beneficiaries, even in instances where fraudulently obtained funds were used to purchase the life insurance. Georgia case law applying §33-25-11 suggest that persons who are alleged victims of fraud, theft, or embezzlement committed or orchestrated by the insured but, who have no connection to the policy (i.e., non-beneficiaries), are considered "creditors", either voluntary or involuntary of the insured for purposes of §33-25-11. *See Speedway Motorsports, Inc. v. Pinnacle Bank*, 727 S.E.2d 151 (2012).

This reasoning has been applied by the Georgia Court of Appeals why there can be no constructive trusts as to death benefits from a term life policy with no case value period. Essentially, to the extent that a term policy is at issue, the equitable remedy of a constructive trust is a non-starter. *See McCrary v. Middle Georgia Management Servs*., Inc., 726 S.E.2d. 247, 248-251 (2012). *McCrary* involved an employer who filed a lawsuit against the daughter of an employee who was the beneficiary of a life insurance policy. After an internal audit following the employee's death, the employer determined that the employee embezzled approximately $2 million, and used part of the money to pay for premiums on a term policy naming the employee's daughter as beneficiary. One of the remedies the employer sought was the imposition of a constructive trust over the proceeds of life insurance policy. In the *McCrary* opinion, the court stated as follows in regard to OGA §33-25-11:

> Under current statutory law, [OGA] §33-25-11, the claim of a creditor to life insurance proceeds cannot defeat a designated beneficiary, absent fraud; and in the event of fraud, only the cash surrender value of the policy is subject to attachment, garnishment, or legal process in favor of the creditor. To the extent that the trial court relied on Ambase for the proposition that the fraud exception could be applied to this case, it erred. At the time Abase was decided in 1990, the fraud exception provided in [OGA] §33-25-11 did not apply to only the cash value of a life insurance policy, as it does today. **Nothing in this Code section authorizes the imposition of a constructive trust over the life insurance proceeds under the facts of this case.**

726 S.E.2d at 742 (emphasis added). Accordingly, when the case involves a term insurance policy with no cash value, the designated beneficiary will likely receive the proceeds to the exclusion of all creditors, regardless of any fraud, embezzlement, or theft.

"AS IS" Residential Contract For Sale And Purchase

THIS FORM HAS BEEN APPROVED BY THE FLORIDA REALTORS AND THE FLORIDA BAR

FloridaRealtors®

PARTIES: _____ ("Seller"), and _____ ("Buyer"), agree that Seller shall sell and Buyer shall buy the following described Real Property and Personal Property (collectively "Property") pursuant to the terms and conditions of this AS IS Residential Contract For Sale And Purchase and any riders and addenda ("Contract"):

1. PROPERTY DESCRIPTION:

(a) Street address, city, zip: _____

(b) Located in: _____ County, Florida. Property Tax ID #: _____

(c) Real Property: The legal description is _____

_____

_____

together with all existing improvements and fixtures, including built-in appliances, built-in furnishings and attached wall-to-wall carpeting and flooring ("Real Property") unless specifically excluded in Paragraph 1(e) or by other terms of this Contract.

(d) Personal Property: Unless excluded in Paragraph 1(e) or by other terms of this Contract, the following items which are owned by Seller and existing on the Property as of the date of the initial offer are included in the purchase: range(s)/oven(s), refrigerator(s), dishwasher(s), disposal, ceiling fan(s), intercom, light fixture(s), drapery rods and draperies, blinds, window treatments, smoke detector(s), garage door opener(s), security gate and other access devices, and storm shutters/panels ("Personal Property").

Other Personal Property items included in this purchase are: _____

_____

Personal Property is included in the Purchase Price, has no contributory value, and shall be left for the Buyer.

(e) The following items are excluded from the purchase: _____

_____

PURCHASE PRICE AND CLOSING

2. PURCHASE PRICE (U.S. currency):..... **$**_____

(a) Initial deposit to be held in escrow in the amount of **(checks subject to COLLECTION)** ..... $_____
The initial deposit made payable and delivered to "Escrow Agent" named below
(CHECK ONE): (i) ☐ accompanies offer or (ii) ☐ is to be made within _____ (if left blank, then 3) days after Effective Date. IF NEITHER BOX IS CHECKED, THEN OPTION (ii) SHALL BE DEEMED SELECTED.
Escrow Agent Information: Name: _____
Address: _____
Phone: _____ E-mail: _____ Fax: _____

(b) Additional deposit to be delivered to Escrow Agent within _____ (if left blank, then 10) days after Effective Date .....$_____
(All deposits paid or agreed to be paid, are collectively referred to as the "Deposit")

(c) Financing: Express as a dollar amount or percentage ("Loan Amount") see Paragraph 8 ..... _____

(d) Other: _____ ..... $_____

(e) Balance to close (not including Buyer's closing costs, prepaids and prorations) by wire transfer or other **COLLECTED** funds ..... $_____
NOTE: For the definition of "COLLECTION" or "COLLECTED" see STANDARD S.

3. TIME FOR ACCEPTANCE OF OFFER AND COUNTER-OFFERS; EFFECTIVE DATE:

(a) If not signed by Buyer and Seller, and an executed copy delivered to all parties on or before _____, this offer shall be deemed withdrawn and the Deposit, if any, shall be returned to Buyer. Unless otherwise stated, time for acceptance of any counter-offers shall be within 2 days after the day the counter-offer is delivered.

(b) The effective date of this Contract shall be the date when the last one of the Buyer and Seller has signed or initialed and delivered this offer or final counter-offer ("Effective Date").

4. CLOSING DATE: Unless modified by other provisions of this Contract, the closing of this transaction shall occur and the closing documents required to be furnished by each party pursuant to this Contract shall be delivered ("Closing") on _____ ("Closing Date"), at the time established by the Closing Agent.

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Appendix 1

5. EXTENSION OF CLOSING DATE:

(a) If Paragraph 8(b) is checked and Closing funds from Buyer's lender(s) are not available on Closing Date due to Consumer Financial Protection Bureau Closing Disclosure delivery requirements ("CFPB Requirements"), then Closing Date shall be extended for such period necessary to satisfy CFPB Requirements, provided such period shall not exceed 10 days.

(b) If an event constituting "Force Majeure" causes services essential for Closing to be unavailable, including the unavailability of utilities or issuance of hazard, wind, flood or homeowners' insurance, Closing Date shall be extended as provided in STANDARD G.

6. OCCUPANCY AND POSSESSION:

(a) Unless the box in Paragraph 6(b) is checked, Seller shall, at Closing, deliver occupancy and possession of the Property to Buyer free of tenants, occupants and future tenancies. Also, at Closing, Seller shall have removed all personal items and trash from the Property and shall deliver all keys, garage door openers, access devices and codes, as applicable, to Buyer. If occupancy is to be delivered before Closing, Buyer assumes all risks of loss to the Property from date of occupancy, shall be responsible and liable for maintenance from that date, and shall be deemed to have accepted the Property in its existing condition as of time of taking occupancy.

(b) ☐ **CHECK IF PROPERTY IS SUBJECT TO LEASE(S) OR OCCUPANCY AFTER CLOSING.** If Property is subject to a lease(s) after Closing or is intended to be rented or occupied by third parties beyond Closing, the facts and terms thereof shall be disclosed in writing by Seller to Buyer and copies of the written lease(s) shall be delivered to Buyer, all within 5 days after Effective Date. If Buyer determines, in Buyer's sole discretion, that the lease(s) or terms of occupancy are not acceptable to Buyer, Buyer may terminate this Contract by delivery of written notice of such election to Seller within 5 days after receipt of the above items from Seller, and Buyer shall be refunded the Deposit thereby releasing Buyer and Seller from all further obligations under this Contract. Estoppel Letter(s) and Seller's affidavit shall be provided pursuant to STANDARD D. If Property is intended to be occupied by Seller after Closing, see Rider U. POST-CLOSING OCCUPANCY BY SELLER.

7. ASSIGNABILITY: (CHECK ONE): Buyer ☐ may assign and thereby be released from any further liability under this Contract; ☐ may assign but not be released from liability under this Contract; or ☐ may not assign this Contract.

FINANCING

8. FINANCING:

☐ (a) Buyer will pay cash for the purchase of the Property at Closing. There is no financing contingency to Buyer's obligation to close. If Buyer obtains a loan for any part of the Purchase Price of the Property, Buyer acknowledges that any terms and conditions imposed by Buyer's lender(s) or by CFPB Requirements shall not affect or extend the Buyer's obligation to close or otherwise affect any terms or conditions of this Contract.

☐ (b) This Contract is contingent upon Buyer obtaining approval of a ☐ conventional ☐ FHA ☐ VA or ☐ other _____ (describe) loan within _____ (if left blank, then 30) days after Effective Date ("Loan Approval Period") for **(CHECK ONE):** ☐ fixed, ☐ adjustable, ☐ fixed or adjustable rate in the Loan Amount (See Paragraph 2(c)), at an initial interest rate not to exceed _____ % (if left blank, then prevailing rate based upon Buyer's creditworthiness), and for a term of _____ (if left blank, then 30) years ("Financing").

(i) Buyer shall make mortgage loan application for the Financing within _____ (if left blank, then 5) days after Effective Date and use good faith and diligent effort to obtain approval of a loan meeting the Financing terms ("Loan Approval") and thereafter to close this Contract. Loan Approval which requires a condition related to the sale by Buyer of other property shall not be deemed Loan Approval for purposes of this subparagraph.

Buyer's failure to use diligent effort to obtain Loan Approval during the Loan Approval Period shall be considered a default under the terms of this Contract. For purposes of this provision, "diligent effort" includes, but is not limited to, timely furnishing all documents and information and paying of all fees and charges requested by Buyer's mortgage broker and lender in connection with Buyer's mortgage loan application.

(ii) Buyer shall keep Seller and Broker fully informed about the status of Buyer's mortgage loan application, Loan Approval, and loan processing and authorizes Buyer's mortgage broker, lender, and Closing Agent to disclose such status and progress, and release preliminary and finally executed closing disclosures and settlement statements, to Seller and Broker.

(iii) Upon Buyer obtaining Loan Approval, Buyer shall promptly deliver written notice of such approval to Seller.

(iv) If Buyer is unable to obtain Loan Approval after the exercise of diligent effort, then at any time prior to expiration of the Loan Approval Period, Buyer may provide written notice to Seller stating that Buyer has been unable to obtain Loan Approval and has elected to either:

(1) waive Loan Approval, in which event this Contract will continue as if Loan Approval had been obtained; or

(2) terminate this Contract.

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(v) If Buyer fails to timely deliver either notice provided in Paragraph 8(b)(iii) or (iv), above, to Seller prior to expiration of the Loan Approval Period, then Loan Approval shall be deemed waived, in which event this Contract will continue as if Loan Approval had been obtained, provided however, Seller may elect to terminate this Contract by delivering written notice to Buyer within 3 days after expiration of the Loan Approval Period.

(vi) If this Contract is timely terminated as provided by Paragraph 8(b)(iv)(2) or (v), above, and Buyer is not in default under the terms of this Contract, Buyer shall be refunded the Deposit thereby releasing Buyer and Seller from all further obligations under this Contract.

(vii) If Loan Approval has been obtained, or deemed to have been obtained, as provided above, and Buyer fails to close this Contract, then the Deposit shall be paid to Seller unless failure to close is due to: (1) Seller's default or inability to satisfy other contingencies of this Contract; (2) Property related conditions of the Loan Approval have not been met (except when such conditions are waived by other provisions of this Contract); or (3) appraisal of the Property obtained by Buyer's lender is insufficient to meet terms of the Loan Approval, in which event(s) the Buyer shall be refunded the Deposit, thereby releasing Buyer and Seller from all further obligations under this Contract.

☐ (c) Assumption of existing mortgage (see rider for terms).

☐ (d) Purchase money note and mortgage to Seller (see riders; addenda; or special clauses for terms).

CLOSING COSTS, FEES AND CHARGES

9. CLOSING COSTS; TITLE INSURANCE; SURVEY; HOME WARRANTY; SPECIAL ASSESSMENTS:

(a) **COSTS TO BE PAID BY SELLER:**

- Documentary stamp taxes and surtax on deed, if any
- Owner's Policy and Charges (if Paragraph 9(c)(i) is checked)
- Title search charges (if Paragraph 9(c)(iii) is checked)
- Municipal lien search (if Paragraph 9(c)(i) or (iii) is checked)
- HOA/Condominium Association estoppel fees
- Recording and other fees needed to cure title
- Seller's attorneys' fees
- Other:_____

If, prior to Closing, Seller is unable to meet the AS IS Maintenance Requirement as required by Paragraph 11 a sum equal to 125% of estimated costs to meet the AS IS Maintenance Requirement shall be escrowed at Closing. If actual costs to meet the AS IS Maintenance Requirement exceed escrowed amount, Seller shall pay such actual costs. Any unused portion of escrowed amount(s) shall be returned to Seller.

(b) **COSTS TO BE PAID BY BUYER:**

- Taxes and recording fees on notes and mortgages
- Recording fees for deed and financing statements
- Owner's Policy and Charges (if Paragraph 9(c)(ii) is checked)
- Survey (and elevation certification, if required)
- Lender's title policy and endorsements
- HOA/Condominium Association application/transfer fees
- Municipal lien search (if Paragraph 9(c)(ii) is checked)
- Loan expenses
- Appraisal fees
- Buyer's Inspections
- Buyer's attorneys' fees
- All property related insurance
- Owner's Policy Premium (if Paragraph 9 (c)(iii) is checked.)
- Other:_____

(c) **TITLE EVIDENCE AND INSURANCE:** At least _____ (if left blank, then 15, or if Paragraph 8(a) is checked, then 5) days prior to Closing Date ("Title Evidence Deadline"), a title insurance commitment issued by a Florida licensed title insurer, with legible copies of instruments listed as exceptions attached thereto ("Title Commitment") and, after Closing, an owner's policy of title insurance (see STANDARD A for terms) shall be obtained and delivered to Buyer. If Seller has an owner's policy of title insurance covering the Real Property, a copy shall be furnished to Buyer and Closing Agent within 5 days after Effective Date. The owner's title policy premium, title search and closing services (collectively, "Owner's Policy and Charges") shall be paid, as set forth below. The title insurance premium charges for the owner's policy and any lender's policy will be calculated and allocated in accordance with Florida law, but may be reported differently on certain federally mandated closing disclosures and other closing documents. For purposes of this Contract "municipal lien search" means a search of records necessary for the owner's policy of title insurance to be issued without exception for unrecorded liens imposed pursuant to Chapters 159 or 170, F.S., in favor of any governmental body, authority or agency.

(CHECK ONE):

☐ (i) Seller shall designate Closing Agent and pay for Owner's Policy and Charges, and Buyer shall pay the premium for Buyer's lender's policy and charges for closing services related to the lender's policy, endorsements and loan closing, which amounts shall be paid by Buyer to Closing Agent or such other provider(s) as Buyer may select; or

☐ (ii) Buyer shall designate Closing Agent and pay for Owner's Policy and Charges and charges for closing services related to Buyer's lender's policy, endorsements and loan closing; or

☐ (iii) [**MIAMI-DADE/BROWARD REGIONAL PROVISION**]**:** Seller shall furnish a copy of a prior owner's policy of title insurance or other evidence of title and pay fees for: (A) a continuation or update of such title evidence, which is acceptable to Buyer's title insurance underwriter for reissue of coverage; (B) tax search; and (C) municipal lien search. Buyer shall obtain and pay for post-Closing continuation and premium for Buyer's owner's policy, and if applicable, Buyer's lender's policy. Seller shall not be obligated to pay more than $_____ (if left blank, then $200.00) for abstract continuation or title search ordered or performed by Closing Agent.

(d) **SURVEY:** On or before Title Evidence Deadline, Buyer may, at Buyer's expense, have the Real Property surveyed and certified by a registered Florida surveyor ("Survey"). If Seller has a survey covering the Real Property, a copy shall be furnished to Buyer and Closing Agent within 5 days after Effective Date.

(e) **HOME WARRANTY:** At Closing, ☐ Buyer ☐ Seller ☐ N/A shall pay for a home warranty plan issued by _____ at a cost not to exceed $_____. A home warranty plan provides for repair or replacement of many of a home's mechanical systems and major built-in appliances in the event of breakdown due to normal wear and tear during the agreement's warranty period.

(f) **SPECIAL ASSESSMENTS:** At Closing, Seller shall pay: (i) the full amount of liens imposed by a public body ("public body" does not include a Condominium or Homeowner's Association) that are certified, confirmed and ratified before Closing; and (ii) the amount of the public body's most recent estimate or assessment for an improvement which is substantially complete as of Effective Date, but that has not resulted in a lien being imposed on the Property before Closing. Buyer shall pay all other assessments. If special assessments may be paid in installments **(CHECK ONE):**

☐ (a) Seller shall pay installments due prior to Closing and Buyer shall pay installments due after Closing. Installments prepaid or due for the year of Closing shall be prorated.

☐ (b) Seller shall pay the assessment(s) in full prior to or at the time of Closing.

IF NEITHER BOX IS CHECKED, THEN OPTION (a) SHALL BE DEEMED SELECTED.

This Paragraph 9(f) shall not apply to a special benefit tax lien imposed by a community development district (CDD) pursuant to Chapter 190, F.S., which lien shall be prorated pursuant to STANDARD K.

DISCLOSURES

10. DISCLOSURES:

(a) **RADON GAS:** Radon is a naturally occurring radioactive gas that, when it is accumulated in a building in sufficient quantities, may present health risks to persons who are exposed to it over time. Levels of radon that exceed federal and state guidelines have been found in buildings in Florida. Additional information regarding radon and radon testing may be obtained from your county health department.

(b) **PERMITS DISCLOSURE:** Except as may have been disclosed by Seller to Buyer in a written disclosure, Seller does not know of any improvements made to the Property which were made without required permits or made pursuant to permits which have not been properly closed. If Seller identifies permits which have not been properly closed or improvements which were not permitted, then Seller shall promptly deliver to Buyer all plans, written documentation or other information in Seller's possession, knowledge, or control relating to improvements to the Property which are the subject of such open permits or unpermitted improvements.

(c) **MOLD:** Mold is naturally occurring and may cause health risks or damage to property. If Buyer is concerned or desires additional information regarding mold, Buyer should contact an appropriate professional.

(d) **FLOOD ZONE; ELEVATION CERTIFICATION:** Buyer is advised to verify by elevation certificate which flood zone the Property is in, whether flood insurance is required by Buyer's lender, and what restrictions apply to improving the Property and rebuilding in the event of casualty. If Property is in a "Special Flood Hazard Area" or "Coastal Barrier Resources Act" designated area or otherwise protected area identified by the U.S. Fish and Wildlife Service under the Coastal Barrier Resources Act and the lowest floor elevation for the building(s) and/or flood insurance rating purposes is below minimum flood elevation or is ineligible for flood insurance coverage through the National Flood Insurance Program or private flood insurance as defined in 42 U.S.C. §4012a, Buyer may terminate this Contract by delivering written notice to Seller within _____ (if left blank, then 20) days after Effective Date, and Buyer shall be refunded the Deposit thereby releasing Buyer and Seller from all further obligations under this Contract, failing which Buyer accepts existing elevation of buildings and flood zone designation of Property. The National Flood Insurance Program may assess additional fees or adjust premiums for pre-Flood Insurance Rate Map (pre-FIRM) non-primary structures (residential structures in which the insured or spouse does not reside for at least 50% of the year) and an elevation certificate may be required for actuarial rating.

(e) **ENERGY BROCHURE:** Buyer acknowledges receipt of Florida Energy-Efficiency Rating Information Brochure required by Section 553.996, F.S.

(f) **LEAD-BASED PAINT:** If Property includes pre-1978 residential housing, a lead-based paint disclosure is mandatory.

(g) **HOMEOWNERS' ASSOCIATION/COMMUNITY DISCLOSURE: BUYER SHOULD NOT EXECUTE THIS CONTRACT UNTIL BUYER HAS RECEIVED AND READ THE HOMEOWNERS' ASSOCIATION/COMMUNITY DISCLOSURE, IF APPLICABLE.**

(h) **PROPERTY TAX DISCLOSURE SUMMARY:** BUYER SHOULD NOT RELY ON THE SELLER'S CURRENT PROPERTY TAXES AS THE AMOUNT OF PROPERTY TAXES THAT THE BUYER MAY BE OBLIGATED TO PAY IN THE YEAR SUBSEQUENT TO PURCHASE. A CHANGE OF OWNERSHIP OR PROPERTY IMPROVEMENTS TRIGGERS REASSESSMENTS OF THE PROPERTY THAT COULD RESULT IN HIGHER PROPERTY TAXES. IF YOU HAVE ANY QUESTIONS CONCERNING VALUATION, CONTACT THE COUNTY PROPERTY APPRAISER'S OFFICE FOR INFORMATION.

(i) **FOREIGN INVESTMENT IN REAL PROPERTY TAX ACT ("FIRPTA"):** Seller shall inform Buyer in writing if Seller is a "foreign person" as defined by the Foreign Investment in Real Property Tax Act ("FIRPTA"). Buyer and Seller shall comply with FIRPTA, which may require Seller to provide additional cash at Closing. If Seller is not a "foreign person", Seller can provide Buyer, at or prior to Closing, a certification of non-foreign status, under penalties of perjury, to inform Buyer and Closing Agent that no withholding is required. See STANDARD V for further information pertaining to FIRPTA. Buyer and Seller are advised to seek legal counsel and tax advice regarding their respective rights, obligations, reporting and withholding requirements pursuant to FIRPTA.

(j) **SELLER DISCLOSURE:** Seller knows of no facts materially affecting the value of the Real Property which are not readily observable and which have not been disclosed to Buyer. Except as provided for in the preceding sentence, Seller extends and intends no warranty and makes no representation of any type, either express or implied, as to the physical condition or history of the Property. Except as otherwise disclosed in writing Seller has received no written or verbal notice from any governmental entity or agency as to a currently uncorrected building, environmental or safety code violation.

PROPERTY MAINTENANCE, CONDITION, INSPECTIONS AND EXAMINATIONS

11. PROPERTY MAINTENANCE: Except for ordinary wear and tear and Casualty Loss, Seller shall maintain the Property, including, but not limited to, lawn, shrubbery, and pool, in the condition existing as of Effective Date ("AS IS Maintenance Requirement").

12. PROPERTY INSPECTION; RIGHT TO CANCEL:

(a) ***PROPERTY INSPECTIONS AND RIGHT TO CANCEL: Buyer shall have _____ (if left blank, then 15) days after Effective Date ("Inspection Period") within which to have such inspections of the Property performed as Buyer shall desire during the Inspection Period. If Buyer determines, in Buyer's sole discretion, that the Property is not acceptable to Buyer, Buyer may terminate this Contract by delivering written notice of such election to Seller prior to expiration of Inspection Period. If Buyer timely terminates this Contract, the Deposit paid shall be returned to Buyer, thereupon, Buyer and Seller shall be released of all further obligations under this Contract; however, Buyer shall be responsible for prompt payment for such inspections, for repair of damage to, and restoration of, the Property resulting from such inspections, and shall provide Seller with paid receipts for all work done on the Property (the preceding provision shall survive termination of this Contract). Unless Buyer exercises the right to terminate granted herein, Buyer accepts the physical condition of the Property and any violation of governmental, building, environmental, and safety codes, restrictions, or requirements, but subject to Seller's continuing AS IS Maintenance Requirement, and Buyer shall be responsible for any and all repairs and improvements required by Buyer's lender.***

(b) **WALK-THROUGH INSPECTION/RE-INSPECTION:** On the day prior to Closing Date, or on Closing Date prior to time of Closing, as specified by Buyer, Buyer or Buyer's representative may perform a walk-through (and follow-up walk-through, if necessary) inspection of the Property solely to confirm that all items of Personal Property are on the Property and to verify that Seller has maintained the Property as required by the AS IS Maintenance Requirement and has met all other contractual obligations.

(c) **SELLER ASSISTANCE AND COOPERATION IN CLOSE-OUT OF BUILDING PERMITS:** If Buyer's inspection of the Property identifies open or needed building permits, then Seller shall promptly deliver to Buyer all plans, written documentation or other information in Seller's possession, knowledge, or control relating to improvements to the Property which are the subject of such open or needed Permits, and shall promptly cooperate in good faith with Buyer's efforts to obtain estimates of repairs or other work necessary to resolve such Permit issues. Seller's obligation to cooperate shall include Seller's execution of necessary authorizations,

consents, or other documents necessary for Buyer to conduct inspections and have estimates of such repairs or work prepared, but in fulfilling such obligation, Seller shall not be required to expend, or become obligated to expend, any money.

(d) **ASSIGNMENT OF REPAIR AND TREATMENT CONTRACTS AND WARRANTIES:** At Buyer's option and cost, Seller will, at Closing, assign all assignable repair, treatment and maintenance contracts and warranties to Buyer.

ESCROW AGENT AND BROKER

13. ESCROW AGENT: Any Closing Agent or Escrow Agent (collectively "Agent") receiving the Deposit, other funds and other items is authorized, and agrees by acceptance of them, to deposit them promptly, hold same in escrow within the State of Florida and, subject to **COLLECTION**, disburse them in accordance with terms and conditions of this Contract. Failure of funds to become **COLLECTED** shall not excuse Buyer's performance. When conflicting demands for the Deposit are received, or Agent has a good faith doubt as to entitlement to the Deposit, Agent may take such actions permitted by this Paragraph 13, as Agent deems advisable. If in doubt as to Agent's duties or liabilities under this Contract, Agent may, at Agent's option, continue to hold the subject matter of the escrow until the parties agree to its disbursement or until a final judgment of a court of competent jurisdiction shall determine the rights of the parties, or Agent may deposit same with the clerk of the circuit court having jurisdiction of the dispute. An attorney who represents a party and also acts as Agent may represent such party in such action. Upon notifying all parties concerned of such action, all liability on the part of Agent shall fully terminate, except to the extent of accounting for any items previously delivered out of escrow. If a licensed real estate broker, Agent will comply with provisions of Chapter 475, F.S., as amended and FREC rules to timely resolve escrow disputes through mediation, arbitration, interpleader or an escrow disbursement order.

In any proceeding between Buyer and Seller wherein Agent is made a party because of acting as Agent hereunder, or in any proceeding where Agent interpleads the subject matter of the escrow, Agent shall recover reasonable attorney's fees and costs incurred, to be paid pursuant to court order out of the escrowed funds or equivalent. Agent shall not be liable to any party or person for mis-delivery of any escrowed items, unless such mis-delivery is due to Agent's willful breach of this Contract or Agent's gross negligence. This Paragraph 13 shall survive Closing or termination of this Contract.

14. PROFESSIONAL ADVICE; BROKER LIABILITY: Broker advises Buyer and Seller to verify Property condition, square footage, and all other facts and representations made pursuant to this Contract and to consult appropriate professionals for legal, tax, environmental, and other specialized advice concerning matters affecting the Property and the transaction contemplated by this Contract. Broker represents to Buyer that Broker does not reside on the Property and that all representations (oral, written or otherwise) by Broker are based on Seller representations or public records. **BUYER AGREES TO RELY SOLELY ON SELLER, PROFESSIONAL INSPECTORS AND GOVERNMENTAL AGENCIES FOR VERIFICATION OF PROPERTY CONDITION, SQUARE FOOTAGE AND FACTS THAT MATERIALLY AFFECT PROPERTY VALUE AND NOT ON THE REPRESENTATIONS (ORAL, WRITTEN OR OTHERWISE) OF BROKER.** Buyer and Seller (individually, the "Indemnifying Party") each individually indemnifies, holds harmless, and releases Broker and Broker's officers, directors, agents and employees from all liability for loss or damage, including all costs and expenses, and reasonable attorney's fees at all levels, suffered or incurred by Broker and Broker's officers, directors, agents and employees in connection with or arising from claims, demands or causes of action instituted by Buyer or Seller based on: (i) inaccuracy of information provided by the Indemnifying Party or from public records; (ii) Indemnifying Party's misstatement(s) or failure to perform contractual obligations; (iii) Broker's performance, at Indemnifying Party's request, of any task beyond the scope of services regulated by Chapter 475, F.S., as amended, including Broker's referral, recommendation or retention of any vendor for, or on behalf of, Indemnifying Party; (iv) products or services provided by any such vendor for, or on behalf of, Indemnifying Party; and (v) expenses incurred by any such vendor. Buyer and Seller each assumes full responsibility for selecting and compensating their respective vendors and paying their other costs under this Contract whether or not this transaction closes. This Paragraph 14 will not relieve Broker of statutory obligations under Chapter 475, F.S., as amended. For purposes of this Paragraph 14, Broker will be treated as a party to this Contract. This Paragraph 14 shall survive Closing or termination of this Contract.

DEFAULT AND DISPUTE RESOLUTION

15. DEFAULT:

(a) **BUYER DEFAULT:** If Buyer fails, neglects or refuses to perform Buyer's obligations under this Contract, including payment of the Deposit, within the time(s) specified, Seller may elect to recover and retain the Deposit for the account of Seller as agreed upon liquidated damages, consideration for execution of this Contract, and in full settlement of any claims, whereupon Buyer and Seller shall be relieved from all further obligations under

this Contract, or Seller, at Seller's option, may, pursuant to Paragraph 16, proceed in equity to enforce Seller's rights under this Contract. The portion of the Deposit, if any, paid to Listing Broker upon default by Buyer, shall be split equally between Listing Broker and Cooperating Broker; provided however, Cooperating Broker's share shall not be greater than the commission amount Listing Broker had agreed to pay to Cooperating Broker.

(b) **SELLER DEFAULT:** If for any reason other than failure of Seller to make Seller's title marketable after reasonable diligent effort, Seller fails, neglects or refuses to perform Seller's obligations under this Contract, Buyer may elect to receive return of Buyer's Deposit without thereby waiving any action for damages resulting from Seller's breach, and, pursuant to Paragraph 16, may seek to recover such damages or seek specific performance.

This Paragraph 15 shall survive Closing or termination of this Contract.

16. DISPUTE RESOLUTION: Unresolved controversies, claims and other matters in question between Buyer and Seller arising out of, or relating to, this Contract or its breach, enforcement or interpretation ("Dispute") will be settled as follows:

(a) Buyer and Seller will have 10 days after the date conflicting demands for the Deposit are made to attempt to resolve such Dispute, failing which, Buyer and Seller shall submit such Dispute to mediation under Paragraph 16(b).

(b) Buyer and Seller shall attempt to settle Disputes in an amicable manner through mediation pursuant to Florida Rules for Certified and Court-Appointed Mediators and Chapter 44, F.S., as amended (the "Mediation Rules"). The mediator must be certified or must have experience in the real estate industry. Injunctive relief may be sought without first complying with this Paragraph 16(b). Disputes not settled pursuant to this Paragraph 16 may be resolved by instituting action in the appropriate court having jurisdiction of the matter. This Paragraph 16 shall survive Closing or termination of this Contract.

17. ATTORNEY'S FEES; COSTS: The parties will split equally any mediation fee incurred in any mediation permitted by this Contract, and each party will pay their own costs, expenses and fees, including attorney's fees, incurred in conducting the mediation. In any litigation permitted by this Contract, the prevailing party shall be entitled to recover from the non-prevailing party costs and fees, including reasonable attorney's fees, incurred in conducting the litigation. This Paragraph 17 shall survive Closing or termination of this Contract.

STANDARDS FOR REAL ESTATE TRANSACTIONS ("STANDARDS")

18. STANDARDS:

A. TITLE:

(i) **TITLE EVIDENCE; RESTRICTIONS; EASEMENTS; LIMITATIONS:** Within the time period provided in Paragraph 9(c), the Title Commitment, with legible copies of instruments listed as exceptions attached thereto, shall be issued and delivered to Buyer. The Title Commitment shall set forth those matters to be discharged by Seller at or before Closing and shall provide that, upon recording of the deed to Buyer, an owner's policy of title insurance in the amount of the Purchase Price, shall be issued to Buyer insuring Buyer's marketable title to the Real Property, subject only to the following matters: (a) comprehensive land use plans, zoning, and other land use restrictions, prohibitions and requirements imposed by governmental authority; (b) restrictions and matters appearing on the Plat or otherwise common to the subdivision; (c) outstanding oil, gas and mineral rights of record without right of entry; (d) unplatted public utility easements of record (located contiguous to real property lines and not more than 10 feet in width as to rear or front lines and 7 1/2 feet in width as to side lines); (e) taxes for year of Closing and subsequent years; and (f) assumed mortgages and purchase money mortgages, if any (if additional items, attach addendum); provided, that, none prevent use of Property for **RESIDENTIAL PURPOSES**. If there exists at Closing any violation of items identified in (b) – (f) above, then the same shall be deemed a title defect. Marketable title shall be determined according to applicable Title Standards adopted by authority of The Florida Bar and in accordance with law.

(ii) **TITLE EXAMINATION:** Buyer shall have 5 days after receipt of Title Commitment to examine it and notify Seller in writing specifying defect(s), if any, that render title unmarketable. If Seller provides Title Commitment and it is delivered to Buyer less than 5 days prior to Closing Date, Buyer may extend Closing for up to 5 days after date of receipt to examine same in accordance with this STANDARD A. Seller shall have 30 days ("Cure Period") after receipt of Buyer's notice to take reasonable diligent efforts to remove defects. If Buyer fails to so notify Seller, Buyer shall be deemed to have accepted title as it then is. If Seller cures defects within Cure Period, Seller will deliver written notice to Buyer (with proof of cure acceptable to Buyer and Buyer's attorney) and the parties will close this Contract on Closing Date (or if Closing Date has passed, within 10 days after Buyer's receipt of Seller's notice). If Seller is unable to cure defects within Cure Period, then Buyer may, within 5 days after expiration of Cure Period,

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deliver written notice to Seller: (a) extending Cure Period for a specified period not to exceed 120 days within which Seller shall continue to use reasonable diligent effort to remove or cure the defects ("Extended Cure Period"); or (b) electing to accept title with existing defects and close this Contract on Closing Date (or if Closing Date has passed, within the earlier of 10 days after end of Extended Cure Period or Buyer's receipt of Seller's notice), or (c) electing to terminate this Contract and receive a refund of the Deposit, thereby releasing Buyer and Seller from all further obligations under this Contract. If after reasonable diligent effort, Seller is unable to timely cure defects, and Buyer does not waive the defects, this Contract shall terminate, and Buyer shall receive a refund of the Deposit, thereby releasing Buyer and Seller from all further obligations under this Contract.

B. SURVEY: If Survey discloses encroachments on the Real Property or that improvements located thereon encroach on setback lines, easements, or lands of others, or violate any restrictions, covenants, or applicable governmental regulations described in STANDARD A (i)(a), (b) or (d) above, Buyer shall deliver written notice of such matters, together with a copy of Survey, to Seller within 5 days after Buyer's receipt of Survey, but no later than Closing. If Buyer timely delivers such notice and Survey to Seller, such matters identified in the notice and Survey shall constitute a title defect, subject to cure obligations of STANDARD A above. If Seller has delivered a prior survey, Seller shall, at Buyer's request, execute an affidavit of "no change" to the Real Property since the preparation of such prior survey, to the extent the affirmations therein are true and correct.

C. INGRESS AND EGRESS: Seller represents that there is ingress and egress to the Real Property and title to the Real Property is insurable in accordance with STANDARD A without exception for lack of legal right of access.

D. LEASE INFORMATION: Seller shall, at least 10 days prior to Closing, furnish to Buyer estoppel letters from tenant(s)/occupant(s) specifying nature and duration of occupancy, rental rates, advanced rent and security deposits paid by tenant(s) or occupant(s)("Estoppel Letter(s)"). If Seller is unable to obtain such Estoppel Letter(s) the same information shall be furnished by Seller to Buyer within that time period in the form of a Seller's affidavit and Buyer may thereafter contact tenant(s) or occupant(s) to confirm such information. If Estoppel Letter(s) or Seller's affidavit, if any, differ materially from Seller's representations and lease(s) provided pursuant to Paragraph 6, or if tenant(s)/occupant(s) fail or refuse to confirm Seller's affidavit, Buyer may deliver written notice to Seller within 5 days after receipt of such information, but no later than 5 days prior to Closing Date, terminating this Contract and receive a refund of the Deposit, thereby releasing Buyer and Seller from all further obligations under this Contract. Seller shall, at Closing, deliver and assign all leases to Buyer who shall assume Seller's obligations thereunder.

E. LIENS: Seller shall furnish to Buyer at Closing an affidavit attesting (i) to the absence of any financing statement, claims of lien or potential lienors known to Seller and (ii) that there have been no improvements or repairs to the Real Property for 90 days immediately preceding Closing Date. If the Real Property has been improved or repaired within that time, Seller shall deliver releases or waivers of construction liens executed by all general contractors, subcontractors, suppliers and materialmen in addition to Seller's lien affidavit setting forth names of all such general contractors, subcontractors, suppliers and materialmen, further affirming that all charges for improvements or repairs which could serve as a basis for a construction lien or a claim for damages have been paid or will be paid at Closing.

F. TIME: Calendar days shall be used in computing time periods. **Time is of the essence in this Contract.** Other than time for acceptance and Effective Date as set forth in Paragraph 3, any time periods provided for or dates specified in this Contract, whether preprinted, handwritten, typewritten or inserted herein, which shall end or occur on a Saturday, Sunday, or a national legal holiday (see 5 U.S.C. 6103) shall extend to 5:00 p.m. (where the Property is located) of the next business day.

G. FORCE MAJEURE: Buyer or Seller shall not be required to perform any obligation under this Contract or be liable to each other for damages so long as performance or non-performance of the obligation, or the availability of services, insurance or required approvals essential to Closing, is disrupted, delayed, caused or prevented by Force Majeure. "Force Majeure" means: hurricanes, floods, extreme weather, earthquakes, fire, or other acts of God, unusual transportation delays, or wars, insurrections, or acts of terrorism, which, by exercise of reasonable diligent effort, the non-performing party is unable in whole or in part to prevent or overcome. All time periods, including Closing Date, will be extended a reasonable time up to 7 days after the Force Majeure no longer prevents performance under this Contract, provided, however, if such Force Majeure continues to prevent performance under this Contract more than 30 days beyond Closing Date, then either party may terminate this Contract by delivering written notice to the other and the Deposit shall be refunded to Buyer, thereby releasing Buyer and Seller from all further obligations under this Contract.

H. CONVEYANCE: Seller shall convey marketable title to the Real Property by statutory warranty, trustee's, personal representative's, or guardian's deed, as appropriate to the status of Seller, subject only to matters described in STANDARD A and those accepted by Buyer. Personal Property shall, at request of Buyer, be

transferred by absolute bill of sale with warranty of title, subject only to such matters as may be provided for in this Contract.

I. CLOSING LOCATION; DOCUMENTS; AND PROCEDURE:

(i) **LOCATION:** Closing will be conducted by the attorney or other closing agent ("Closing Agent") designated by the party paying for the owner's policy of title insurance and will take place in the county where the Real Property is located at the office of the Closing Agent, or at such other location agreed to by the parties. If there is no title insurance, Seller will designate Closing Agent. Closing may be conducted by mail, overnight courier, or electronic means.

(ii) **CLOSING DOCUMENTS:** Seller shall at or prior to Closing, execute and deliver, as applicable, deed, bill of sale, certificate(s) of title or other documents necessary to transfer title to the Property, construction lien affidavit(s), owner's possession and no lien affidavit(s), and assignment(s) of leases. Seller shall provide Buyer with paid receipts for all work done on the Property pursuant to this Contract. Buyer shall furnish and pay for, as applicable, the survey, flood elevation certification, and documents required by Buyer's lender.

(iii) **FinCEN GTO NOTICE**. **If Closing Agent is required to comply with the U.S. Treasury Department's Financial Crimes Enforcement Network ("FinCEN") Geographic Targeting Orders ("GTOs"), then Buyer shall provide Closing Agent with the information related to Buyer and the transaction contemplated by this Contract that is required to complete IRS Form 8300, and Buyer consents to Closing Agent's collection and report of said information to IRS.**

(iv) **PROCEDURE:** The deed shall be recorded upon **COLLECTION** of all closing funds. If the Title Commitment provides insurance against adverse matters pursuant to Section 627.7841, F.S., as amended, the escrow closing procedure required by STANDARD J shall be waived, and Closing Agent shall, **subject to COLLECTION of all closing funds**, disburse at Closing the brokerage fees to Broker and the net sale proceeds to Seller.

J. ESCROW CLOSING PROCEDURE: If Title Commitment issued pursuant to Paragraph 9(c) does not provide for insurance against adverse matters as permitted under Section 627.7841, F.S., as amended, the following escrow and closing procedures shall apply: (1) all Closing proceeds shall be held in escrow by the Closing Agent for a period of not more than 10 days after Closing; (2) if Seller's title is rendered unmarketable, through no fault of Buyer, Buyer shall, within the 10 day period, notify Seller in writing of the defect and Seller shall have 30 days from date of receipt of such notification to cure the defect; (3) if Seller fails to timely cure the defect, the Deposit and all Closing funds paid by Buyer shall, within 5 days after written demand by Buyer, be refunded to Buyer and, simultaneously with such repayment, Buyer shall return the Personal Property, vacate the Real Property and re-convey the Property to Seller by special warranty deed and bill of sale; and (4) if Buyer fails to make timely demand for refund of the Deposit, Buyer shall take title as is, waiving all rights against Seller as to any intervening defect except as may be available to Buyer by virtue of warranties contained in the deed or bill of sale.

K. PRORATIONS; CREDITS: The following recurring items will be made current (if applicable) and prorated as of the day prior to Closing Date, or date of occupancy if occupancy occurs before Closing Date: real estate taxes (including special benefit tax assessments imposed by a CDD), interest, bonds, association fees, insurance, rents and other expenses of Property. Buyer shall have option of taking over existing policies of insurance, if assumable, in which event premiums shall be prorated. Cash at Closing shall be increased or decreased as may be required by prorations to be made through day prior to Closing. Advance rent and security deposits, if any, will be credited to Buyer. Escrow deposits held by Seller's mortgagee will be paid to Seller. Taxes shall be prorated based on current year's tax. If Closing occurs on a date when current year's millage is not fixed but current year's assessment is available, taxes will be prorated based upon such assessment and prior year's millage. If current year's assessment is not available, then taxes will be prorated on prior year's tax. If there are completed improvements on the Real Property by January 1st of year of Closing, which improvements were not in existence on January 1st of prior year, then taxes shall be prorated based upon prior year's millage and at an equitable assessment to be agreed upon between the parties, failing which, request shall be made to the County Property Appraiser for an informal assessment taking into account available exemptions. In all cases, due allowance shall be made for the maximum allowable discounts and applicable homestead and other exemptions. A tax proration based on an estimate shall, at either party's request, be readjusted upon receipt of current year's tax bill. This STANDARD K shall survive Closing.

L. ACCESS TO PROPERTY TO CONDUCT APPRAISALS, INSPECTIONS, AND WALK-THROUGH: Seller shall, upon reasonable notice, provide utilities service and access to Property for appraisals and inspections, including a walk-through (or follow-up walk-through if necessary) prior to Closing.

M. RISK OF LOSS: If, after Effective Date, but before Closing, Property is damaged by fire or other casualty ("Casualty Loss") and cost of restoration (which shall include cost of pruning or removing damaged trees) does not exceed 1.5% of Purchase Price, cost of restoration shall be an obligation of Seller and Closing shall proceed pursuant to terms of this Contract. If restoration is not completed as of Closing, a sum equal to 125% of estimated

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cost to complete restoration (not to exceed 1.5% of Purchase Price) will be escrowed at Closing. If actual cost of restoration exceeds escrowed amount, Seller shall pay such actual costs (but, not in excess of 1.5% of Purchase Price). Any unused portion of escrowed amount shall be returned to Seller. If cost of restoration exceeds 1.5% of Purchase Price, Buyer shall elect to either take Property "as is" together with the 1.5%, or receive a refund of the Deposit thereby releasing Buyer and Seller from all further obligations under this Contract. Seller's sole obligation with respect to tree damage by casualty or other natural occurrence shall be cost of pruning or removal.

N. 1031 EXCHANGE: If either Seller or Buyer wish to enter into a like-kind exchange (either simultaneously with Closing or deferred) under Section 1031 of the Internal Revenue Code ("Exchange"), the other party shall cooperate in all reasonable respects to effectuate the Exchange, including execution of documents; provided, however, cooperating party shall incur no liability or expense related to the Exchange, and Closing shall not be contingent upon, nor extended or delayed by, such Exchange.

O. CONTRACT NOT RECORDABLE; PERSONS BOUND; NOTICE; DELIVERY; COPIES; CONTRACT EXECUTION: Neither this Contract nor any notice of it shall be recorded in any public records. This Contract shall be binding on, and inure to the benefit of, the parties and their respective heirs or successors in interest. Whenever the context permits, singular shall include plural and one gender shall include all. Notice and delivery given by or to the attorney or broker (including such broker's real estate licensee) representing any party shall be as effective as if given by or to that party. All notices must be in writing and may be made by mail, personal delivery or electronic (including "pdf") media. A facsimile or electronic (including "pdf") copy of this Contract and any signatures hereon shall be considered for all purposes as an original. This Contract may be executed by use of electronic signatures, as determined by Florida's Electronic Signature Act and other applicable laws.

P. INTEGRATION; MODIFICATION: This Contract contains the full and complete understanding and agreement of Buyer and Seller with respect to the transaction contemplated by this Contract and no prior agreements or representations shall be binding upon Buyer or Seller unless included in this Contract. No modification to or change in this Contract shall be valid or binding upon Buyer or Seller unless in writing and executed by the parties intended to be bound by it.

Q. WAIVER: Failure of Buyer or Seller to insist on compliance with, or strict performance of, any provision of this Contract, or to take advantage of any right under this Contract, shall not constitute a waiver of other provisions or rights.

R. RIDERS; ADDENDA; TYPEWRITTEN OR HANDWRITTEN PROVISIONS: Riders, addenda, and typewritten or handwritten provisions shall control all printed provisions of this Contract in conflict with them.

S. COLLECTION or COLLECTED: "COLLECTION" or "COLLECTED" means any checks tendered or received, including Deposits, have become actually and finally collected and deposited in the account of Escrow Agent or Closing Agent. Closing and disbursement of funds and delivery of closing documents may be delayed by Closing Agent until such amounts have been COLLECTED in Closing Agent's accounts.

T. RESERVED.

U. APPLICABLE LAW AND VENUE: This Contract shall be construed in accordance with the laws of the State of Florida and venue for resolution of all disputes, whether by mediation, arbitration or litigation, shall lie in the county where the Real Property is located.

V. FIRPTA TAX WITHHOLDING: If a seller of U.S. real property is a "foreign person" as defined by FIRPTA, Section 1445 of the Internal Revenue Code ("Code") requires the buyer of the real property to withhold up to 15% of the amount realized by the seller on the transfer and remit the withheld amount to the Internal Revenue Service (IRS) unless an exemption to the required withholding applies or the seller has obtained a Withholding Certificate from the IRS authorizing a reduced amount of withholding.

(i) No withholding is required under Section 1445 of the Code if the Seller is not a "foreign person". Seller can provide proof of non-foreign status to Buyer by delivery of written certification signed under penalties of perjury, stating that Seller is not a foreign person and containing Seller's name, U.S. taxpayer identification number and home address (or office address, in the case of an entity), as provided for in 26 CFR 1.1445-2(b). Otherwise, Buyer shall withhold the applicable percentage of the amount realized by Seller on the transfer and timely remit said funds to the IRS.

(ii) If Seller is a foreign person and has received a Withholding Certificate from the IRS which provides for reduced or eliminated withholding in this transaction and provides same to Buyer by Closing, then Buyer shall withhold the reduced sum required, if any, and timely remit said funds to the IRS.

(iii) If prior to Closing Seller has submitted a completed application to the IRS for a Withholding Certificate and has provided to Buyer the notice required by 26 CFR 1.1445-1(c) (2)(i)(B) but no Withholding Certificate has been received as of Closing, Buyer shall, at Closing, withhold the applicable percentage of the amount realized by Seller on the transfer and, at Buyer's option, either (a) timely remit the withheld funds to the IRS or (b) place the funds in escrow, at Seller's expense, with an escrow agent selected by Buyer and pursuant to terms negotiated by the

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parties, to be subsequently disbursed in accordance with the Withholding Certificate issued by the IRS or remitted directly to the IRS if the Seller's application is rejected or upon terms set forth in the escrow agreement.

(iv) In the event the net proceeds due Seller are not sufficient to meet the withholding requirement(s) in this transaction, Seller shall deliver to Buyer, at Closing, the additional COLLECTED funds necessary to satisfy the applicable requirement and thereafter Buyer shall timely remit said funds to the IRS or escrow the funds for disbursement in accordance with the final determination of the IRS, as applicable.

(v) Upon remitting funds to the IRS pursuant to this STANDARD, Buyer shall provide Seller copies of IRS Forms 8288 and 8288-A, as filed.

W. RESERVED

X. BUYER WAIVER OF CLAIMS: ***To the extent permitted by law, Buyer waives any claims against Seller and against any real estate licensee involved in the negotiation of this Contract for any damage or defects pertaining to the physical condition of the Property that may exist at Closing of this Contract and be subsequently discovered by the Buyer or anyone claiming*** **by, through, under or against the Buyer.** ***This provision does not relieve Seller's obligation to comply with Paragraph 10(j). This Standard X shall survive Closing.***

ADDENDA AND ADDITIONAL TERMS

19. ADDENDA: The following additional terms are included in the attached addenda or riders and incorporated into this Contract (**Check if applicable**):

- ☐ A. Condominium Rider
- ☐ B. Homeowners' Assn.
- ☐ C. Seller Financing
- ☐ D. Mortgage Assumption
- ☐ E. FHA/VA Financing
- ☐ F. Appraisal Contingency
- ☐ G. Short Sale
- ☐ H. Homeowners/Flood Ins.
- ☐ I. RESERVED
- ☐ J. Interest-Bearing Acct.
- ☐ K. RESERVED
- ☐ L. RESERVED
- ☐ M. Defective Drywall
- ☐ N. Coastal Construction Control Line
- ☐ O. Insulation Disclosure
- ☐ P. Lead Paint Disclosure (Pre-1978)
- ☐ Q. Housing for Older Persons
- ☐ R. Rezoning
- ☐ S. Lease Purchase/ Lease Option
- ☐ T. Pre-Closing Occupancy
- ☐ U. Post-Closing Occupancy
- ☐ V. Sale of Buyer's Property
- ☐ W. Back-up Contract
- ☐ X. Kick-out Clause
- ☐ Y. Seller's Attorney Approval
- ☐ Z. Buyer's Attorney Approval
- ☐ AA. Licensee Property Interest
- ☐ BB. Binding Arbitration
- ☐ Other: _____

20. ADDITIONAL TERMS: _____

COUNTER-OFFER/REJECTION

☐ Seller counters Buyer's offer (to accept the counter-offer, Buyer must sign or initial the counter-offered terms and deliver a copy of the acceptance to Seller).

☐ Seller rejects Buyer's offer.

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THIS IS INTENDED TO BE A LEGALLY BINDING CONTRACT. IF NOT FULLY UNDERSTOOD, SEEK THE ADVICE OF AN ATTORNEY PRIOR TO SIGNING.

THIS FORM HAS BEEN APPROVED BY THE FLORIDA REALTORS AND THE FLORIDA BAR.

Approval of this form by the Florida Realtors and The Florida Bar does not constitute an opinion that any of the terms and conditions in this Contract should be accepted by the parties in a particular transaction. Terms and conditions should be negotiated based upon the respective interests, objectives and bargaining positions of all interested persons.

AN ASTERISK (*) FOLLOWING A LINE NUMBER IN THE MARGIN INDICATES THE LINE CONTAINS A BLANK TO BE COMPLETED.

Buyer: _____ Date: _____

Buyer: _____ Date: _____

Seller: _____ Date: _____

Seller: _____ Date: _____

Buyer's address for purposes of notice	Seller's address for purposes of notice
_____	_____
_____	_____
_____	_____

BROKER: Listing and Cooperating Brokers, if any, named below (collectively, "Broker"), are the only Brokers entitled to compensation in connection with this Contract. Instruction to Closing Agent: Seller and Buyer direct Closing Agent to disburse at Closing the full amount of the brokerage fees as specified in separate brokerage agreements with the parties and cooperative agreements between the Brokers, except to the extent Broker has retained such fees from the escrowed funds. This Contract shall not modify any MLS or other offer of compensation made by Seller or Listing Broker to Cooperating Brokers.

_____	_____
Cooperating Sales Associate, if any	**Listing Sales Associate**
_____	_____
Cooperating Broker, if any	**Listing Broker**

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NATIONAL ASKING CAP RATES

Sector	Q1 2020 (Previous)	Q2 2020 (Current)	Basis Point Change
Retail	6.15%	6.25%	+10
Office	7.00%	7.00%	0
Industrial	7.05%	6.99%	-6

NUMBER OF PROPERTIES ON THE MARKET

Sector	Q1 2020 (Previous)	Q2 2020 (Current)	Percentage Change
Retail	3,264	3,480	6.61%
Office	380	393	3.42%
Industrial	315	354	12.44%

MEDIAN NATIONAL ASKING VS CLOSED CAP RATE SPREAD

Sector	Q1 2020 (Previous)	Q2 2020 (Current)	Basis Point Change
Retail	30	22	-8
Office	34	40	+6
Industrial	25	16	-9

MARKET OVERVIEW

Cap rates in the single tenant net lease retail sector increased by 10 basis points to 6.25% in the second quarter of 2020 when compared to the prior quarter. Cap rates for net lease office properties were unchanged at 7.00% while industrial properties compressed by 6 basis points to 6.99%. Throughout the second quarter, transaction velocity was greatly impacted by Covid-19 and the effects it had on business resulting from government mandated shutdowns. Transaction volume in the first half of 2020 declined in excess of 20% when compared to 2019 in the net lease sector.

In a recent national survey conducted by The Boulder Group, 80% of net lease participants expect cap rates to increase by the end of 2020; with 43% expecting an increase of up to 19 basis points. As investors become more conservative, properties with investment grade rated tenants and minimal impact from Covid-19 are more in favor within the net lease sector.

In the second quarter of 2020 the net lease market was bifurcated between essential and non-essential businesses. Investor interest was largely focused on essential businesses that were open and operational including pharmacies, quick service restaurants, grocery, c-stores and dollar stores. Businesses labeled non-essential and largely shut down or significantly impacted include movie theaters, fitness centers, soft goods retailers and sit down dining. Investors backed away from non-essential businesses while waiting to see if the financial stress continues to effect tenants.

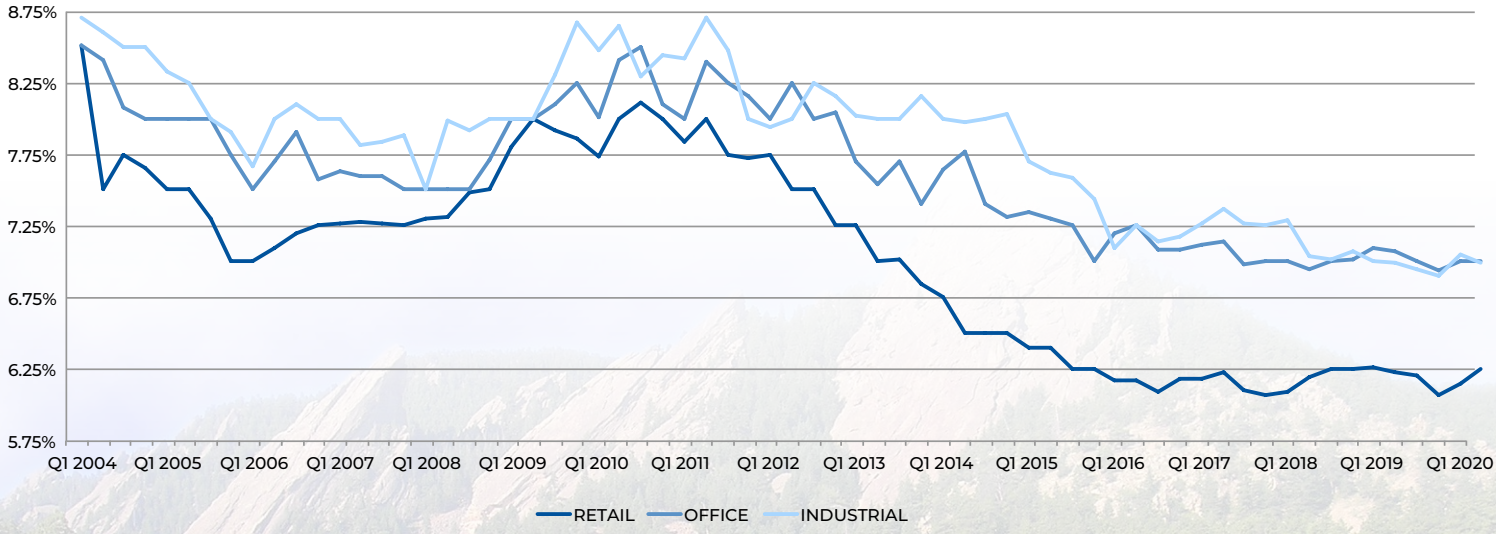
There was a significant flight to quality by private investors who were looking to avoid the volatility of alternative investment vehicles and the stock market. Long term leases to credit tenants including 7-Eleven, CVS and McDonald's represented some of the lowest cap rates in the sector in the second quarter. Competition amongst investors for high quality net lease product can be evidenced by the bid-ask spread in the second quarter of 2020. The spread between asking and closed cap rates compressed by 8 and 9 basis points respectively for retail and industrial sectors.

Net lease transaction volume for 2020 is expected to be significantly lower than 2019 as a result of the impact of Covid-19. Investors will carefully monitor the economy's reopening and the financial health of tenants. The stabilization of the 10 Year Treasury Yield in the second quarter will provide investors with an enticing yield spread for the net lease sector.

SELECTED SINGLE TENANT SALES COMPARABLES

Sale Date	Sector	Tenant	City	State	Price	Price Per SF	Cap Rate	Lease Term Remaining
May-20	Retail	Pick 'N Save	Menomonee Falls	WI	$28,428,268	$274	6.00%	11
Apr-20	Industrial	Material Science Corporation	Elk Grove Village	IL	$17,935,000	$90	6.50%	11
Mar-20	Office	Amazon	Huntington	WV	$16,851,771	$245	7.00%	7
Jan-00	Office	US Bank	Marshall	MN	$13,487,000	$142	8.39%	6
May-20	Retail	Walmart	Sylacauga	AL	$12,850,000	$72	6.30%	10
Apr-20	Industrial	Shore Education Collaborative	Chelsea	MA	$10,400,000	$327	6.50%	13
May-20	Office	CVS	Knoxville	TN	$10,250,000	$172	7.85%	8
May-20	Retail	CVS	Bowie	MD	$9,550,000	$722	4.94%	21
Jun-20	Retail	Walgreens	Greensboro	NC	$9,525,000	$698	6.19%	15
May-20	Retail	Walmart	Newark	NY	$9,150,000	$55	6.52%	14
May-20	Office	GSA - Homeland Security	Reno	NV	$9,100,000	$499	7.20%	5
May-20	Retail	CVS	Washington	DC	$7,960,000	$687	5.00%	17
Jun-20	Industrial	PepsiCo	Capitol Heights	MD	$7,785,000	$390	5.50%	10
Apr-20	Industrial	Wilbert Plastic Services	Harrisburg	NC	$7,500,000	$59	7.25%	10
Jun-20	Retail	7-Eleven	Venice	FL	$6,513,026	$2,164	4.99%	15
Jun-20	Retail	7-Eleven	Richmond	VA	$6,500,000	$1,890	5.20%	15
Apr-20	Retail	Citibank	Skokie	IL	$6,450,000	$1,808	5.60%	10
Apr-20	Retail	Wawa (GL)	Daytona Beach	FL	$6,050,500	$989	4.71%	20
Jun-20	Retail	Walgreens	Gilbert	AZ	$5,625,000	$380	6.76%	10
Apr-20	Retail	Caliber Collision	Mount Pleasant	SC	$5,300,000	$362	6.11%	15

NET LEASE CAP RATE TRENDS



MEDIAN ASKING CAP RATES BY YEAR BUILT

Tenant	2017-2020	2011-2016	2005-2010	Pre 2005
7-Eleven	4.90%	5.10%	5.50%	6.05%
Advance Auto Parts	6.00%	6.50%	6.80%	7.15%
AutoZone	5.50%	5.65%	6.85%	7.35%
Bank of America	5.00%	5.60%	6.10%	6.75%
Chase Bank	4.50%	4.75%	5.55%	6.20%
CVS Pharmacy	5.05%	5.50%	5.85%	7.00%
DaVita Dialysis Center	5.85%	6.10%	6.90%	7.30%
Dollar General	6.60%	7.00%	7.75%	8.25%
Family Dollar	7.00%	7.15%	8.00%	8.50%
FedEx	6.00%	6.50%	6.75%	7.25%
Fresenius	5.88%	6.15%	6.80%	7.25%
McDonald's (GL)	3.90%	4.15%	4.50%	5.00%
O'Reilly Auto Parts	5.40%	5.85%	6.00%	6.75%
Rite Aid	N/A	7.15%	8.00%	9.00%
Starbucks	5.15%	5.75%	6.15%	6.40%
Walgreens	5.50%	5.75%	6.50%	7.35%

FOR MORE INFORMATION

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THE NET LEASE AUTO PARTS REPORT

AUTO PARTS STORE PROPERTIES MEDIAN ASKING CAP RATES

Tenant	Q4 2018 (Previous)	Q4 2019 (Current)	Basis Point Change
Advance Auto Parts	6.75%	6.95%	+20
AutoZone	5.47%	5.70%	+23
O'Reilly Auto Parts	5.80%	5.85%	+5

AUTO PARTS STORE PROPERTIES MEDIAN ASKING PRICE

Tenant	Median Asking Price	Median Price Per Foot
Advance Auto Parts	$1,352,000	$203
AutoZone	$1,658,000	$248
O'Reilly Auto Parts	$1,602,000	$240

PERCENTAGE OF AUTO PARTS STORES ON THE MARKET BY TENANT

Tenant	Percentage of Market
Advance Auto Parts	56%
AutoZone	19%
O'Reilly Auto Parts	25%

AUTO PARTS STORE PROPERTIES VS. RETAIL NET LEASE MARKET

Tenant	Q4 2018 (Previous)	Q4 2019 (Current)
Auto Parts	6.26%	6.44%
Market	6.25%	6.07%
Spread (bps)	+1	+37

MARKET OVERVIEW

Cap rates for the single tenant net leased auto parts store sector increased by 18 basis points from the fourth quarter of 2018 to the fourth quarter of 2019 to 6.44%. The auto parts sector, for the purpose of this report, is defined as Advance Auto Parts, AutoZone and O'Reilly Auto Parts as they account for the highest percentage of single tenant transactions of properties occupied by auto parts retailers. The primary reason contributing to the increase in cap rates was an increase in supply of vintage properties with shorter lease term remaining. In the fourth quarter of 2019, the median remaining lease term for the sector decreased to 7 years, down from 9 years one year earlier.

The majority of the sector is comprised of Advance Auto Parts properties (56%), which have cap rates significantly higher than its competitors. In the fourth quarter of 2019, properties tenanted by Advance Auto Parts, had cap rates of 6.95% - an increase of 20 basis points when compared to 2018. Advance Auto Parts were priced at more than a 100 basis point discount to AutoZone and O'Reilly Auto Parts properties. This was primarily due to a slightly lower credit rating associated with Advance Auto Parts and a greater supply of shorter term leases in the market.

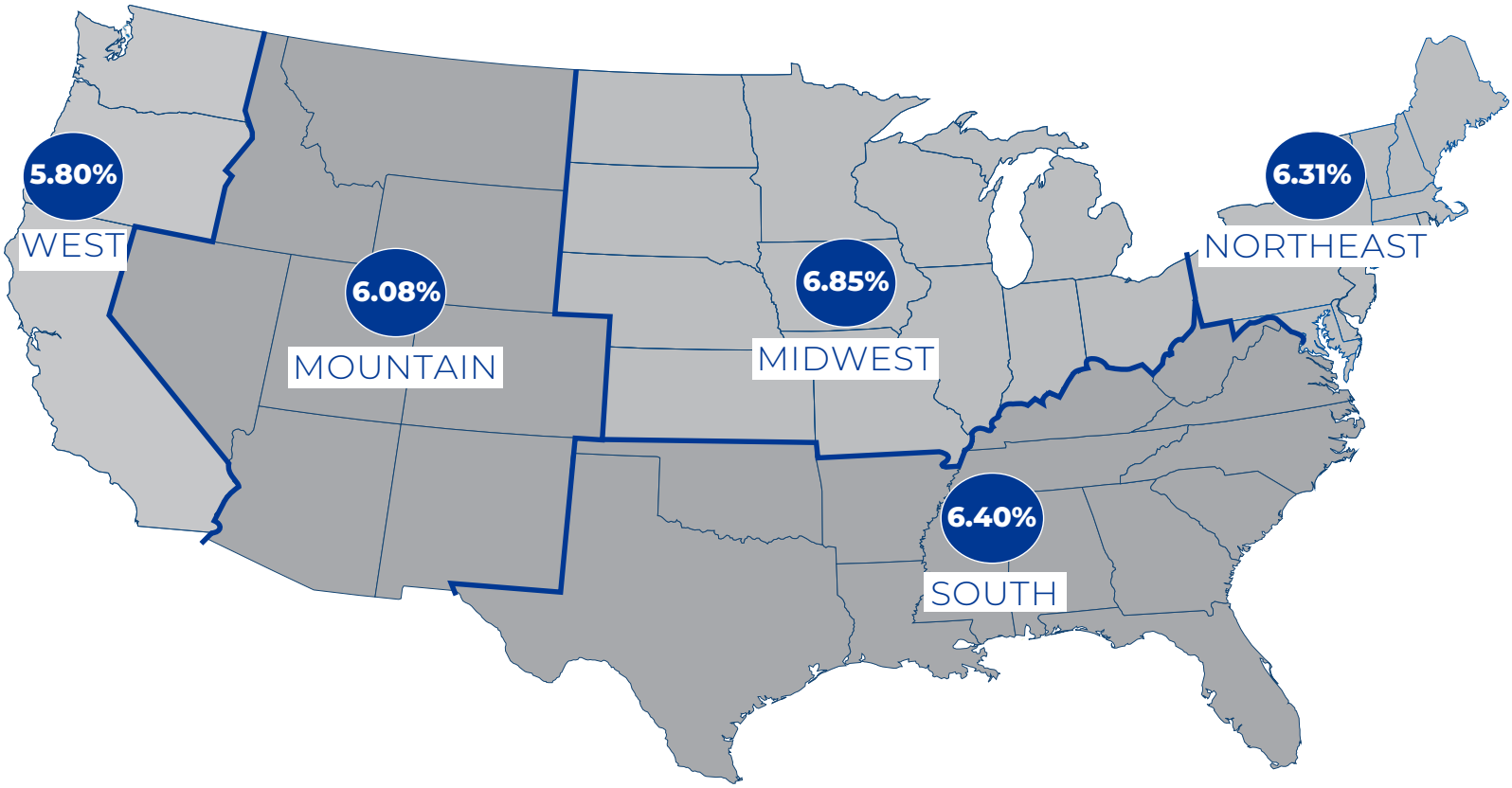
As the current vehicle fleet in the United States continues to age, investors are seeking properties occupied by auto parts retailers. According to IHS Markit, the typical age of a vehicle on the road is approximately 12 years old. This represents an all-time high and has increased an average of 4% over the last five years. The aging car fleet drives auto part demand from consumers, garages and service stations.

In 2019, transaction volume in the net lease auto parts retail sector increased by approximately 6% over 2018. The low absolute price point of properties within the net lease auto parts store sector make these investments attractive to investors. Outside of dollar stores, there is a limited supply of net leased properties available under $2 million leased to investment grade rated tenants.

Transaction volume in the auto parts sector should remain similar to 2019 as investors continue to seek properties with investment grade tenants at lower price points. However, there will be increased competition amongst new construction assets as the average remaining lease term for the sector continues to dwindle. Auto parts store properties with shorter lease terms located in areas with strong real estate fundamentals also remain in high demand among buyers seeking higher yields.

THE NET LEASE AUTO PARTS REPORT

AUTO PARTS STORES MEDIAN ASKING CAP RATES



MEDIAN ASKING CAP RATES BY LEASE TERM REMAINING

Years Remaining	Advance Auto Parts	AutoZone	O'Reilly Auto Parts
Under 5	7.92%	7.40%	7.00%
6-9 Years	7.19%	6.56%	6.55%
10-14 Years	6.50%	5.87%	6.12%
15-17 Years	6.00%	5.50%	5.80%
18-20 Years	N/A	5.37%	5.40%

SELECTED SINGLE TENANT AUTO PARTS STORES SALE COMPARABLES

Sale Date	Tenant	City	State	Price	Price/SF	Cap Rate	Lease Term Remaning
Nov-19	Advance Auto Parts	Richmond	VA	$2,180,000	$322	6.10%	10
Oct-19	Advance Auto Parts	Groton	CT	$2,020,000	$289	6.93%	6
Oct-19	Advance Auto Parts	Taneytown	MD	$1,650,000	$242	7.64%	6
Oct-19	Advance Auto Parts	Hardeeville	SC	$1,367,444	$198	6.30%	12
Dec-19	Advance Auto Parts	Greenwood	MS	$1,340,000	$192	8.67%	2
Nov-19	Advance Auto Parts	Martinez	GA	$1,217,296	$151	8.54%	5
Oct-19	Advance Auto Parts	North Versailles	PA	$936,900	$142	8.02%	3
Dec-19	AutoZone (GL)	Flagstaff	AZ	$3,333,333	$452	5.10%	15
Oct-19	AutoZone	Chicago	IL	$2,407,935	$352	6.20%	9
Nov-19	AutoZone	Rincon	GA	$2,235,000	$303	5.64%	12
Jan-20	AutoZone	Rome	GA	$2,100,000	$285	5.70%	9
Dec-19	O'Reilly Auto Parts	Crestwood	KY	$1,850,000	$260	5.77%	19
Nov-19	O'Reilly Auto Parts	Paragould	AR	$1,655,677	$175	5.75%	15
Nov-19	O'Reilly Auto Parts	Orem	UT	$1,923,740	$200	5.61%	10
Oct-19	O'Reilly Auto Parts	Oakland	TN	$1,675,000	$246	5.62%	18

AUTO PARTS STORES COMPANY COMPARISONS

	Advance Auto Parts	AutoZone	O'Reilly Auto Parts
Credit Rating:	BBB- (Stable)	BBB (Stable)	BBB+ (Stable)
Market Cap:	$9.2 billion	$25 billion	$31.2 billion
Revenue:	$9.6 billion	$11.9 billion	$9.54 billion
Number of Stores:	5,200	6000+	5,219
Typical Lease Term:	15 year primary term with fifteen years of options	15 year primary term with twenty years of options	20 year primary term with twenty years of options

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THE NET LEASE BANK GROUND LEASE REPORT

BANK GROUND LEASE PROPERTIES MEDIAN ASKING CAP RATES

Tenant	Q1 2019 (Previous)	Q1 2020 (Current)	Basis Point Change
Bank of America	4.50%	4.92%	+42
Chase Bank	5.00%	4.67%	-33
PNC Bank	4.55%	4.85%	+30
TD Bank	5.35%	4.50%	-85
Other Banks	5.15%	5.30%	+15
All Bank Ground Leases	4.84%	4.96%	+12

The above data reflects bank ground leases with 12 or more lease years remaining.

BANK GROUND LEASE PROPERTIES MEDIAN ASKING PRICE

Tenant	Median Price
Bank of America	$3,894,000
Chase Bank	$4,250,000
PNC Bank	$3,328,000
TD Bank	$5,850,000
Other Banks	$2,925,000
All Bank Ground Leases	$3,450,000

The above data reflects bank ground leases with 12 or more lease years remaining.

MEDIAN ASKING CAP RATE BY LEASE TERM REMAINING

Lease Term Remaining	Cap Rate
20+	4.40%
15-19	4.79%
10-14	5.10%
Under 10	6.00%

MARKET OVERVIEW

**This report is based on events that occurred throughout the first quarter of 2020, which does not fully take into account the evolving Covid-19 situation and its effect on the net lease market.*

Cap rates for the single tenant bank ground lease sector increased by 17 basis points to 5.47% in the first quarter of 2020 compared to one year ago. In the past three years, cap rates in the bank ground lease sector increased by more than 80 basis points while net lease retail cap rates compressed by 4 basis points. The continued increase in cap rates can be attributed to investor concern surrounding the future of consumer banking and a lack of new bank branch locations with long-term ground leases. For the purpose of this report, the bank ground lease sector is comprised of both national and regional banks.

In the first quarter of 2020, the supply of bank ground leases was heavily concentrated in short term leases. For the second consecutive year, the median term remaining for the bank ground lease sector was below 10 years. Consequently, the premium in cap rates historically associated with bank ground leases has compressed considerably. In the first quarter of 2020, the premium for bank ground leases when compared to the overall net lease retail sector compressed from 97 to 68 basis points. In 2013 – 2015, this premium was 200+ basis points.

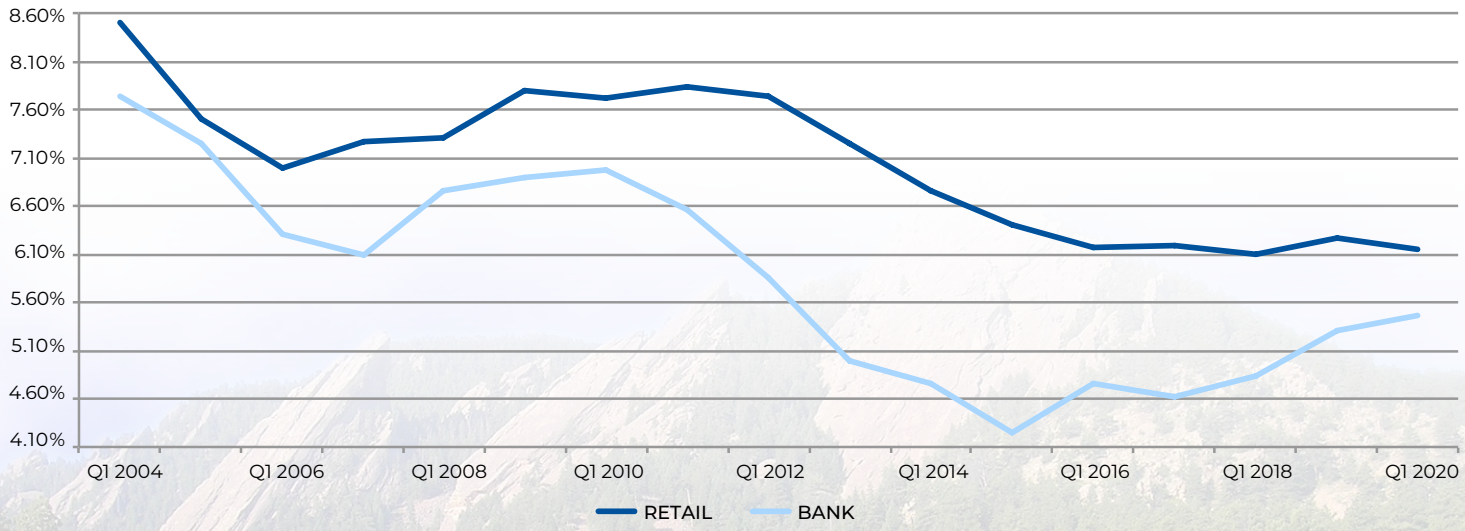
While relocation and consolidation of existing branches is common today, new branch expansion remains very limited. This is causing a decreased supply of long term leased bank properties that command a cap rate premium. In the first quarter of 2020, less than 10% of the overall bank ground lease sector was comprised of properties with 15 or more years remaining on their ground leases. As a result, bank ground leases with 20+ years of remaining lease term commanded asking cap rates of 4.40% while ground leases with 15-19 years of term asked 4.79%.

Investor interest in bank ground leases will remain as investors continue to value the credit quality of the tenants, passive nature of ground leases and favorable locations. However, demand for bank ground leases will remain fragmented between long term credit investors and others who desire the underlying real estate of the bank property. Accordingly, in-place rental rates and bank branch deposits will be carefully scrutinized by bank ground lease investors.

SELECTED BANK GROUND LEASE SALE COMPARABLES

Sale Date	Tenant	City	State	Price	Cap Rate	Lease Term Remaning
Dec-19	PNC Bank (GL)	Woodbridge	VA	$7,350,000	7.19%	8
Dec-19	Regions Bank (GL)	Houston	TX	$5,783,133	4.15%	20
Mar-20	Chase Bank (GL)	Anaheim	CA	$5,100,000	3.63%	20
Mar-20	Bank of America (GL)	Centennial	CO	$5,075,000	4.61%	15
Jan-20	Bank of America (GL)	Northbrook	IL	$4,639,000	4.85%	15
Mar-20	Chase (GL)	Gilbert	AZ	$4,628,000	5.15%	9
Jan-20	PNC Bank (GL)	Niles	IL	$4,100,000	6.05%	11
Feb-20	Chase (GL)	Bonita Springs	FL	$4,093,023	4.30%	13
Nov-19	Chase Bank (GL)	Miami	FL	$4,050,000	4.32%	20
Jan-20	Chase Bank (GL)	Hillside	IL	$3,275,000	5.75%	10
Apr-20	PNC Bank (GL)	Brookfield	WI	$2,500,000	5.00%	14
Apr-20	Andigo Credit Union (GL)	Streamwood	IL	$2,250,000	6.00%	15
Dec-19	Bank of America (GL)	Lithonia	GA	$1,680,715	6.90%	3
Feb-20	Compass Bank (GL)	Fort Walton Beach	FL	$1,440,000	6.43%	8
Jan-20	Republic Bank (GL)	New Port Richey	FL	$1,092,000	5.00%	10

BANK GROUND LEASE VS RETAIL NET LEASE CAP RATE TRENDS



THE NET LEASE BANK GROUND LEASE REPORT

COMPANY COMPARISON

Tenant	Number of Branches	Credit Rating	Market Cap (Billions)
Associated Bank	230	BBB+	$1.8
Bank of America	4,212	A-	$185.0
Truist Financial	2,049	A-	$40.0
BMO Harris	600	A+	$31.0
Chase Bank	5,100	A+	$266.0
Citibank	4,600	BBB+	$85.0
Fifth Third	1,154	A-	$10.6
KeyBank	1,197	A-	$11.0
PNC Bank	2,459	A	$38.0
Regions Bank	1,454	A-	$8.5
TCF Bank	500	BBB-	$3.4
TD Bank	1,301	AA-	$70.9
US Bank	3,067	A+	$48.2
Wells Fargo	8,050	A-	$109.5

MEDIAN CLOSED CAP RATE SPREAD

Tenant	Closed	Ask	Spread (bps)
Bank Ground Leases	5.28%	4.96%	32

The above data reflects bank ground leases with 12 or more lease years remaining.

BANK GROUND LEASE SECTOR VS NET LEASE SECTOR CAP RATE

Tenant	Q1 2019 (Previous)	Q1 2020 (Current)
Bank Ground Lease Sector	5.30%	5.47%
Retail Net Lease Market	6.27%	6.15%
Bank Ground Lease Premium (bps)	97	68

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THE Boulder GROUP

Q1 2020 THE NET LEASE CASUAL DINING MARKET REPORT

CORPORATE LEASED PROPERTIES MEDIAN ASKING CAP RATES

Tenant	Q1 2019 (Previous)	Q1 2020 (Current)	Basis Point Change
Buffalo Wild Wings	6.35%	6.40%	+5
Chili's	5.65%	5.85%	+20
Hooters	6.30%	6.20%	-10
IHOP	6.15%	6.30%	+15
Outback Steakhouse	5.43%	5.50%	+7
Red Lobster	6.15%	6.25%	+10
Texas Roadhouse (GL)	5.15%	5.00%	-15
All Corporate Casual Dining	6.15%	6.25%	+10

FRANCHISEE LEASED PROPERTIES MEDIAN ASKING PRICE

Tenant	Q1 2019 (Previous)	Q1 2020 (Current)	Basis Point Change
Applebees	7.10%	7.35%	+25
Denny's	6.40%	6.45%	+5
IHOP	6.70%	6.70%	0
All Franchisee Casual Dining	6.85%	7.00%	+15

CASUAL DINING PROPERTIES MEDIAN ASKING PRICE

Tenant	Median Price
All Casual Dining	$2,824,900
Applebees	$2,900,000
Buffalo Wild Wings	$3,150,000
Chili's Grill & Bar	$3,250,000
Denny's	$2,250,000
Hooters	$2,100,000
IHOP	$2,750,000
Outback Steakhouse	$4,200,000
Red Lobster	$3,950,000
Texas Roadhouse	$2,850,000
TGI Friday's	$2,650,000

MARKET OVERVIEW

**This report is based on events that occurred throughout the first quarter of 2020, which does not fully take into account the evolving Covid-19 situation and its effect on the net lease market.*

Cap rates in the net lease casual dining sector increased to 6.59% representing a 27 basis point increase in the first quarter of 2020 when compared to the first quarter of 2019. Casual dining properties with corporately guaranteed leases generated cap rates of 6.25%, while franchisee leased properties had cap rates of 7.00%. Both corporate and franchisee guaranteed leases experienced increases of 10 and 15 basis points respectively over the past year. Cap rates for casual dining properties leased to franchisees can vary depending on the strength of the guarantor. The primary factor contributing to the increase in cap rates was the softening of the casual dining segment. This is especially true for certain tenants including Applebee's which experienced a 25 basis point increase in cap rates in the first quarter of 2020.

In the first quarter of 2020, casual dining properties were priced at a 44 basis point discount to the overall net lease retail market. Cap rates in the casual dining sector increased by 27 basis points year over year while the overall net lease retail contracted by 12 basis points. Most attribute the rise in cap rates for casual dining properties to specific brands, including Ruby Tuesday, Red Robin and Golden Corral, that have failed to keep up with changing consumer preferences.

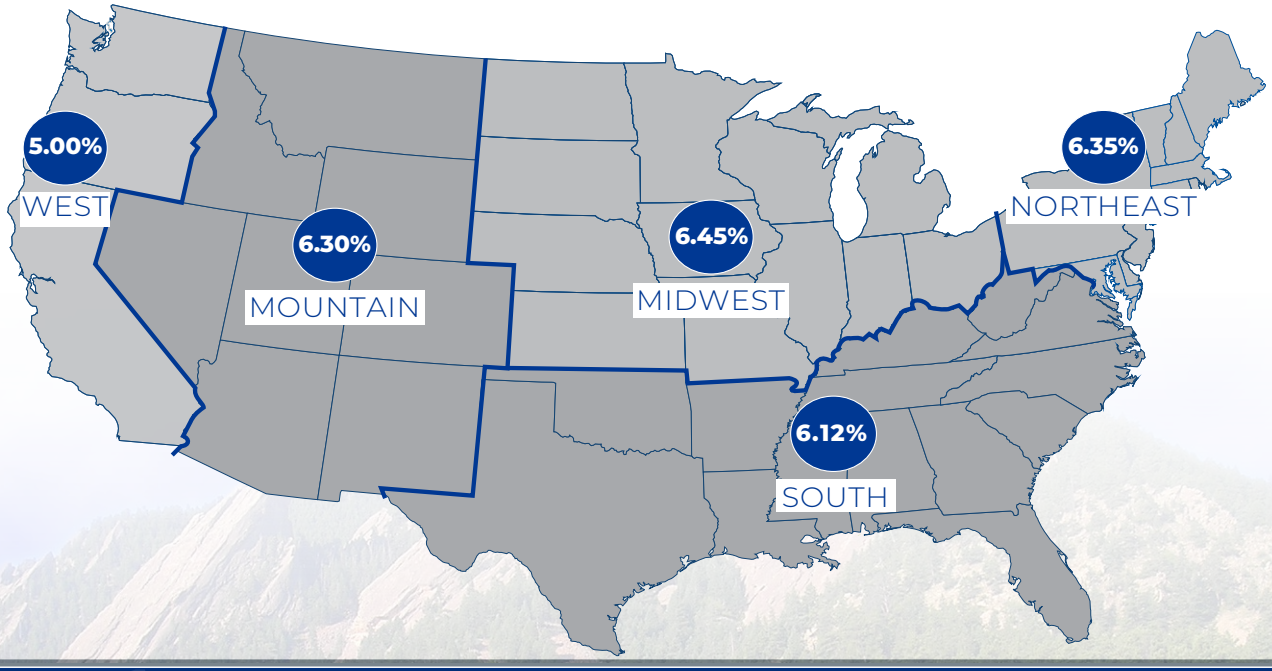
Casual dining tenants were greatly impacted by Covid-19 during the late stages of the first quarter. As many casual dining tenants were forced to shift focus to carryout and delivery, they saw sales volumes drop significantly as dine-in services were suspended. Casual dining tenants will need to prove sustainability of concept in order for transaction velocity to begin again. Additionally, investors will be seeking casual dining brands that have ongoing business models that can take advantage of the increased success of curbside services offered during the current Covid-19 period.

Investors are carefully monitoring how restaurants perform during their re-opening stages with limited seating capacity prior to making acquisitions. Investors will pay closer attention to in-place rents, sales performance, residual real estate and the strength of the lease guarantor and restaurant brand. Corporately guaranteed leases or large franchisees with strong financials will remain in the highest demand among private investors due to investors flight to quality response in this sector.

SELECTED SINGLE TENANT SALES COMPARABLES

Sale Date	Tenant	City	State	Price	Price/SF	Cap Rate	Lease Term Remaning
Mar-20	Red Lobster	Arlington	TX	$7,650,000	$817	5.98%	20
Feb-20	Walk On's	Texarkana	TX	$6,120,000	$551	6.90%	15
Mar-20	Outback Steakhouse	Fredericksburg	VA	$3,458,000	$567	5.35%	10
Mar-20	IHOP	Schererville	IN	$3,048,000	$438	5.35%	20
Mar-20	Bob Evans	Sunbury	OH	$2,720,000	$409	5.95%	18
Feb-20	Applebee's	Duluth	GA	$2,599,000	$589	7.68%	4
Jan-20	Buffalo Wild Wings	Benton	AR	$2,380,000	$420	7.00%	12
Feb-20	Denny's	Abilene	TX	$2,327,000	$310	5.49%	20
Feb-20	Ruby Tuesday	Litchfield	IL	$2,162,000	$538	6.74%	18
Mar-20	Ruby Tuesday	Walterboro	SC	$2,100,000	$553	7.14%	18
Mar-20	McAlister's Deli	Clermont	FL	$1,925,000	$454	6.61%	10
Feb-20	IHOP	Oakland Park	FL	$1,725,000	$597	7.83%	2

CASUAL DINING MEDIAN ASKING CAP RATE BY REGION



THE Boulder GROUP

Q1 2020 THE NET LEASE CASUAL DINING MARKET REPORT

CASUAL DINING VS RETAIL NET LEASE MARKET CAP RATES

Sector	Q1 2019 (Previous)	Q1 2020 (Current)
Casual Dining Sector	6.32%	6.59%
Retail Net Lease Market	6.27%	6.15%
Differential (bps)	+5	+44

MEDIAN ASKING CAP RATE BY LEASE TERM REMAINING

Lease Term Remaining	Cap Rate
20+ Years	5.80%
15-19 Years	6.00%
10-14 Years	6.70%
5-9 Years	7.00%
Under 5 Years	7.35%

MEDIAN NATIONAL CLOSED CAP RATE SPREAD

Tenant	Closing	Asking	Spread (bps)
Casual Dining	6.82%	6.59%	+23

CASUAL DINING ASKING CAP RATE BY GUARANTOR

Tenant	Corporate Cap Rate	Franchise Cap Rate	Spread (bps)
Casual Dining	6.25%	7.00%	75

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THE NET LEASE DRUG STORE REPORT

DRUG STORE PROPERTIES MEDIAN ASKING CAP RATES

Tenant	Q3 2018 (Previous)	Q3 2019 (Current)	Basis Point Change
Walgreens	6.15%	6.06%	-9
CVS	5.65%	5.60%	-5
Rite Aid	7.32%	7.65%	+33

Note: Above numbers include properties with all lease lengths.

DRUG STORE PROPERTIES ON THE MARKET

Tenant	Q3 2018 (Previous)	Q3 2019 (Current)	Percentage Change
Walgreens	158	175	10.8%
CVS	98	112	14.3%
Rite Aid	58	67	15.5%

DRUG STORE PROPERTIES MEDIAN ASKING PRICE

Tenant	Median Asking Price	Median Price Per Foot
Walgreens	$6,250,000	$435
CVS	$5,500,000	$495
Rite Aid	$3,725,000	$285

MARKET OVERVIEW

Cap rates for the single tenant drug store sector increased by a single basis point in the third quarter of 2019 to 6.22% when compared to last year. Cap rates for CVS and Walgreens properties experienced decreases of 5 and 9 basis points to 5.60% and 6.06% respectively. However, single tenant Rite Aid properties experienced a 33 basis points increase to 7.65%. Drug store transaction volume in 2018 was significantly lower than in 2017 primarily attributed to concerns about store overlap and potential closings from the Walgreens and Rite Aid deal. However, in the first three quarters of 2019 the drug store sector experienced a 25% increase in transaction volume when compared to 2018.

Walgreens properties experienced their first decrease in cap rates since the third quarter of 2015. The decrease in cap rates is due to more transparency for Walgreens stores following the acquisition of approximately 1,900 stores from Rite Aid. While Walgreens has not rebranded all of the Rite Aid stores they have acquired, landlords have been notified if their stores are under a new drug store brand. Accordingly, many landlords with a new sense of clarity brought properties to market in 2019. The overall drug store sector experienced an increase in property supply of almost 13%. Walgreens and Rite Aid properties increased by 10.8% and 15.5% respectively.

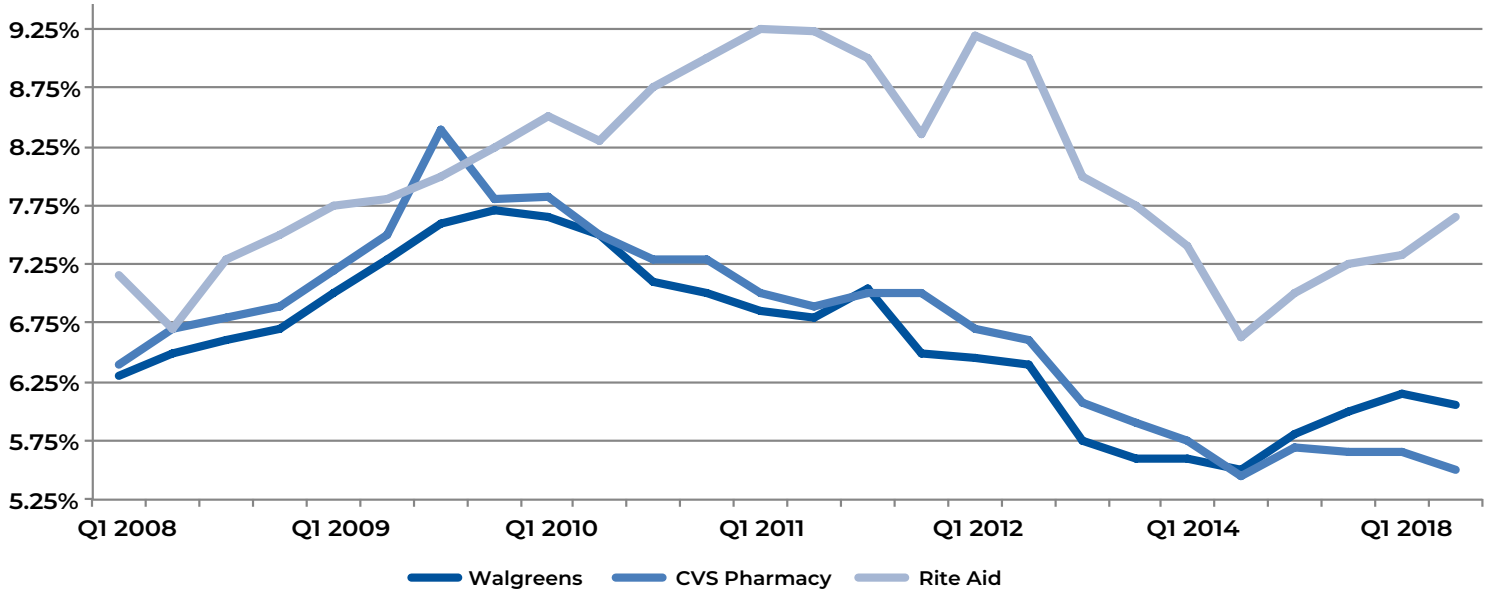
While there is now a better understanding of Walgreens and Rite Aid stores, many investors have a preference for CVS properties. CVS properties typically have lower rent resulting in greater popularity from investors. In the third quarter of 2019, CVS properties with more than 20 years remaining of lease term had cap rates 25 basis points lower than Walgreens properties. The same differential held true for properties with 15 to 19 years of lease term remaining. Despite the popularity of CVS, some investors have concern with CVS assets as they typically do not disclose store level performance in contrast to Walgreens and Rite Aid which regularly provide store sales.

Transaction velocity for the remainder of 2019 should continue to increase as investors are once again targeting the drug store sector. Private and 1031 investors will continue to be the primary buyers of drug store assets. Furthermore, the vast majority of transactions will consist of stores with high quality real estate and superior store sales or long term leases.

MEDIAN ASKING CAP RATE BY LEASE TERM REMAINING

Term Remaining	Walgreens	CVS	Rite Aid
20+ Years	5.40%	5.15%	6.75%
15-19 Years	5.60%	5.35%	7.00%
10-14 Years	5.90%	5.90%	7.35%
6-9 Years	6.75%	6.25%	8.00%
5 Years & Under	7.50%	7.15%	9.00%

CAP RATE DRUG STORE TRENDS



MEDIAN NATIONAL ASKING VS. CLOSED CAP RATE SPREAD

Tenant	Closed	Asking	Spread (bps)
Walgreens	6.28%	6.06%	22
CVS	5.80%	5.60%	20
Rite Aid	8.00%	7.65%	35

DRUG STORE VS. RETAIL NET LEASE MARKET CAP RATE

Sector	Q3 2018 (Previous)	Q3 2019 Current
Drug Store	6.21%	6.22%
Market	6.25%	6.21%
Differential (bps)	-4	+1

SELECTED SINGLE TENANT SALES COMPARABLES

Sale Date	Tenant	City	State	Price	Price Per SF	Cap Rate	Lease Term Remaining
Aug-19	CVS	Washington	DC	$15,000,000	$1,714	5.84%	9
Aug-19	Walgreens	Sanger	CA	$6,826,000	$495	6.40%	15
Jul-19	Walgreens	Sacramento	CA	$6,260,000	$432	6.23%	7
Jul-19	Walgreens	Newport News	VA	$6,240,000	$430	6.25%	11
Jul-19	Walgreens	New Castle	IN	$6,030,000	$350	6.60%	14
Aug-19	CVS	Detroit	MI	$1,740,000	$160	5.80%	15
Aug-19	CVS	Cypress	TX	$3,825,480	$318	5.20%	19
Jul-19	Walgreens	Papillion	NE	$4,816,000	$325	6.70%	15
Jul-19	CVS	Cheraw	SC	$1,727,302	$169	5.50%	20
Jul-19	CVS	Crystal River	FL	$3,641,850	$334	7.22%	5
Jul-19	Walgreens	Warwick	RI	$2,300,000	$221	11.68%	6
Jul-19	Walgreens	Saint Louis	MO	$4,877,698	$329	6.95%	15
Oct-19	CVS	Poulsbo	WA	$8,895,000	$613	5.00%	22
Sep-19	Walgreens	Orlando	FL	$8,450,000	$581	5.21%	14
Sep-19	CVS	Pensacola	FL	$5,236,538	$468	5.20%	5
Oct-19	Rite Aid	Virginia Beach	VA	$4,483,000	$347	8.25%	4
Sep-19	Walgreens	Liverpool	NY	$4,070,000	$373	7.36%	9
Sep-19	Walgreens	Ocean Springs	MS	$2,825,093	$263	7.48%	6
Oct-19	CVS	Newnan	GA	$3,992,492	$307	6.40%	13
Oct-19	Walgreens	Phoenix	AZ	$7,050,000	$487	6.80%	8
Oct-19	Walgreens	Ballwin	MO	$8,465,000	$584	6.53%	14
Oct-19	Walgreens	Providence	RI	$3,300,000	$237	7.25%	8
Sep-19	Walgreens	Omaha	NE	$6,125,664	$413	5.65%	19
Sep-19	Walgreens	Cocoa	FL	$4,533,188	$300	6.92%	9
Sep-19	Walgreens (DARK)	Clinton Township	MI	$3,475,000	$240	9.30%	10
Sep-19	Rite Aid	Granite Falls	WA	$7,147,508	$414	7.12%	9
Aug-19	Walgreens	Brooklyn	NY	$12,800,000	$1,012	5.47%	12
Aug-19	Walgreens	North Highlands	CA	$7,075,000	$488	5.82%	13
Aug-19	Walgreens	Mantua	NJ	$6,100,000	$578	6.33%	11
Aug-19	Walgreens	Mesquite	NV	$4,039,000	$248	7.33%	5

COMPANY AND LEASE OVERVIEW

	Walgreens	CVS Pharmacy	Rite Aid
Credit Rating:	BBB	BBB+	B
Market Cap:	$49 billion	$86 billion	$490 million
Revenue:	$136 billion	$226 billion	$21.6 billion
Number of Stores:	9,560	9,900	2,496
Typical Lease Term:	20 year primary term with fifty years of options	25 year primary term with six 5-year options	20 year primary term with six 5-year options
Typical Rent Increases:	None	None in primary 10% increases in option preiods	Increases of 10% every 10 years

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Q2 2019 THE NET LEASE QSR MARKET REPORT

QSR (CORPORATE) PROPERTIES MEDIAN ASKING CAP RATES

Tenant	Q2 2018 (Previous)	Q2 2019 (Current)	Basis Point Change
All Corporate QSR	5.24%	5.20%	-4
Chick Fil A (Ground Lease)	4.05%	4.05%	0
McDonald's (Ground Lease)	4.10%	4.08%	-2
Panera Bread	4.90%	4.86%	-4
Starbucks	5.22%	5.30%	+8

QSR (FRANCHISEE) PROPERTIES MEDIAN ASKING CAP RATES

Tenant	Q2 2018 (Previous)	Q2 2019 (Current)	Basis Point Change
All Franchisee QSR	5.71%	5.68%	-3
Burger King	5.90%	5.80%	-10
Dunkin Donuts	5.50%	5.50%	0
KFC	6.00%	5.95%	-5
Pizza Hut	6.40%	6.57%	+17
Taco Bell	5.50%	5.43%	-7
Wendy's	5.62%	5.50%	-12

QSR PROPERTIES MEDIAN ASKING PRICE

Tenant	Median Price
All QSR	$1,900,000
Burger King	$1,748,000
Chick Fil A (Ground Lease)	$2,850,000
Dunkin Donuts	$1,675,000
KFC	$1,466,000
McDonald's (Ground Lease)	$1,920,000
Panera Bread	$3,600,000
Pizza Hut	$1,154,000
Starbucks	$2,050,000
Taco Bell	$2,195,000
Wendy's	$2,200,000

MARKET OVERVIEW

Cap rates in the net lease quick service restaurant (QSR) sector declined to 5.39% in the second quarter of 2019 representing an 11 basis point decline when compared to the prior year. Cap rates for corporate leased QSR properties decreased by 4 basis points to a 5.20% cap rate while QSR properties leased to franchisees declined by 3 basis points to a 5.68% cap rate. One of the primary reasons that net lease investors are targeting this sector is the financial transparency these assets typically offer. Landlords are able to demonstrate performance through store level sales, tenant financials and profit & loss statements, providing investors a level of transparency in many instances. The QSR sector continues to be a popular trade target for private and 1031 investors as the QSR sector is e-commerce resistant and service oriented.

Within the QSR sector, the financial backing of a lease can vary from a corporate guarantee from a large, public company like McDonald's down to a franchisee with a single location. Accordingly, cap rates can vary drastically depending on the financial strength of the tenant. In the second quarter of 2019, corporately backed leases generated a 48 basis point premium over its franchisee backed counterpart. One of the main benefits to franchisee backed leases is that they typically contain provisions that require the tenant to share store sales with the landlord.

Investors gravitate to the QSR market as it offers a lower price alternative to dollar stores and auto part retailers. Contrary to dollar and auto part stores, the leases associated with QSR properties frequently have rental escalations every five years or on an annual basis. Throughout the first half of 2019, private and 1031 buyers acquired the majority of QSR properties. More than 80% of the QSR properties acquired by the end of second quarter in 2019 were purchased by private buyers. New construction properties tenanted by Burger King, Popeyes, Dunkin' and Starbucks experienced the greatest transaction volume year to date in 2019 include.

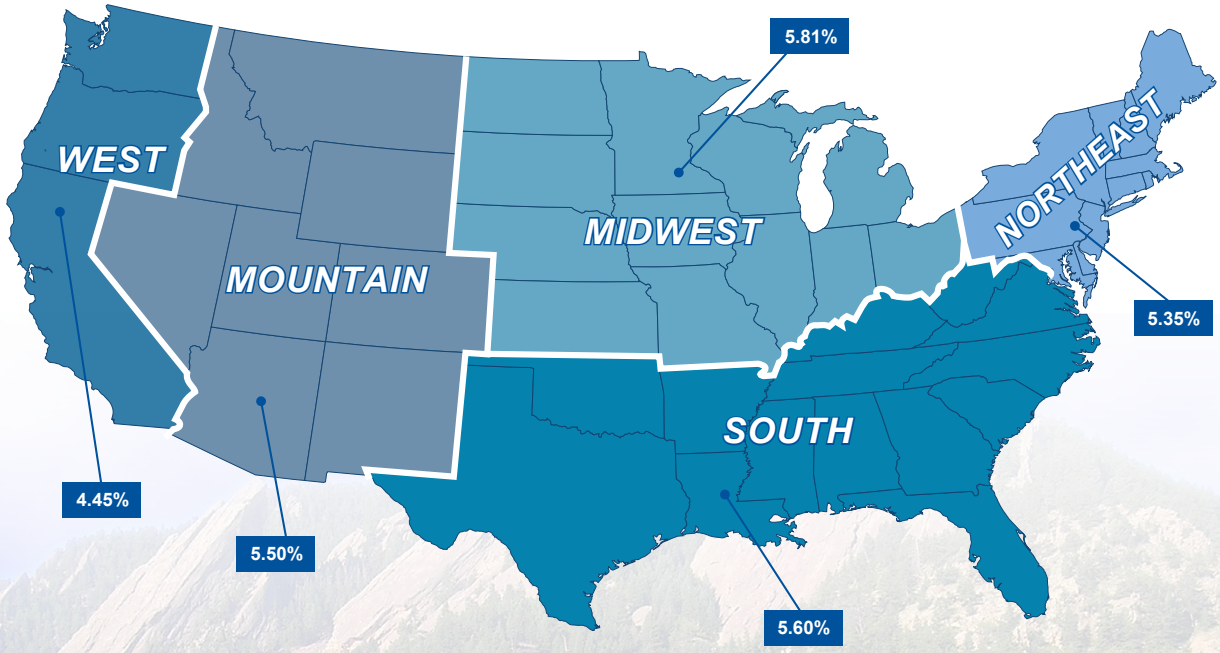
The single tenant net lease QSR sector will continue to garner significant investor demand as many investors continue to emphasize investments that are "Amazon-proof". Furthermore, despite the private and 1031 investors acquiring the majority of the assets, institutional groups will continue to seek larger portfolios of QSR properties via sale leaseback to obtain economies of scale.

SELECTED COMPANY COMPARISON

Tenant	Number of Locations	Ticker Symbol	Market Cap
Arby's	3,472	Private	Private
Burger King	17,796	QSR	$12.5 B
Carl's Jr.	1,490	Private	Private
Chick Fil A	2,363	Private	Private
Chipotle	2,500	CMG	$22 B
Dunkin' Donuts	12,000	DNKN	$7 B
Hardee's	1,860	Private	Private
Jack in the Box	2,200	JACK	$2.2 B
KFC	22,000	YUM	$36 B
McDonald's	37,855	MCD	$166 B
Panda Express	2,000+	Private	Private
Panera Bread	2,100	PNRA	Private
Pizza Hut	7,000	YUM	$36 B
Popeyes	3,102	PLKI	$1.6 B
Sonic Drive-In	3,615	SONC	Private
Starbucks	30,000	SBUX	$115 B
Taco Bell	7,072	YUM	$36 B
Wendy's	6,711	WEN	$4.6 B
Whataburger	824	Private	Private

Leases can be guaranteed by franchisees or corporations.

NET LEASE QSR PROPERTIES MEDIAN ASKING CAP RATE BY REGION



THE Boulder GROUP

Q2 2019 THE NET LEASE QSR MARKET REPORT

QSR VS RETAIL NET LEASE MARKET CAP RATES

Sector	Q2 2018 (Previous)	Q2 2019 (Current)
QSR Sector	5.50%	5.39%
Retail Net Lease Market	6.20%	6.23%
QSR Premium (bps)	70	84

MEDIAN ASKING CAP RATE BY LEASE TERM REMAINING

Lease Term Remaining	Cap Rate
20+	5.25%
15-19	5.40%
10-14	5.75%
Under 10	6.30%

MEDIAN NATIONAL CLOSED CAP RATE SPREAD

Sector	Closed	Asking	Spread (bps)
QSR Sector	5.60%	5.39%	+21

QSR ASKING CAP RATE BY GUARANTOR

Tenant	Corporate Cap Rate	Franchise Cap Rate	Spread (bps)
QSR	5.20%	5.68%	48

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BIG BOX ASKING CAP RATE COMPARISON

Q4 2018 (Previous)	Q4 2019 (Current)	Basis Point Change
7.04%	7.00%	-4

BIG BOX VS. NET LEASE SECTOR MEDIAN ASKING PRICE

Sector	Q4 2018 (Previous)	Q4 2019 (Current)
Big Box	7.04%	7.00%
Retail Net Lease Market	6.25%	6.07%
Differential (bps)	+79	+93

BIG BOX PROPERTIES MEDIAN ASKING PRICE

Sector	Average Price	Average Price Per SF
Investment Grade	$9,215,000	$130 PSF
Non-Investment Grade	$5,769,230	$158 PSF

BIG BOX MEDIAN ASKING CAP RATE BY CREDIT RATING

Investment Grade Cap Rate	Non-Investment Grade Cap Rate	Basis Point Spread
6.00%	7.25%	+125

MARKET OVERVIEW

Cap rates in the single tenant net lease big box sector decreased by 4 basis points to 7.00% from the fourth quarter of 2018 to the fourth quarter of 2019. The decrease in cap rates can be primarily attributed to a compressed cap rate environment for the entire net lease market. Additionally, there was an uptick in supply of big box properties with investment grade rated tenants in 2019 when compared to the prior year.

While cap rates decreased slightly for the single tenant big box sector, they still ultimately priced at a discount within the overall net lease retail market. In the fourth quarter of 2019, net lease big box properties were priced at a 93 basis point discount to the overall net lease market, 14 basis points higher than in the fourth quarter of 2018. This delta in cap rates for net lease retail versus big box properties illustrates a growing trend of increasing yields for big box properties. In 2015 cap rates for net lease big box properties had a 17 basis point premium over the entire net lease retail market.

With an ongoing focus on tenant financial health for net lease retailers as e-commerce continues to disrupt, investors put premiums on properties with high quality tenancy. In the fourth quarter of 2019, properties with investment grade rated tenants had a 125 basis point cap rate premium over those without. Regardless, non-credit big box properties with strong underlying real estate or below market rents, will continue to garner demand from investors.

Despite the issues making headlines within the big box retail space, big box properties in 2019 surpassed transaction volume for 2018. The net lease big box market was fueled by large portfolio/sale leaseback transaction by tenants including Albertsons, Bass Pro Shops, Regal Cinemas and others. Institutional investors looking to place large amounts of capital with higher yielding returns, capitalized on retailers transitioning to an asset light ownership approach.

The single tenant net lease big box sector will remain active as investors seeking higher yields will target these assets. As the big box retailer environment continues to evolve, investors will be carefully monitoring tenant financial health and placing strong emphasis on the underlying real estate.

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Q4 2019

THE NET LEASE BIG BOX REPORT

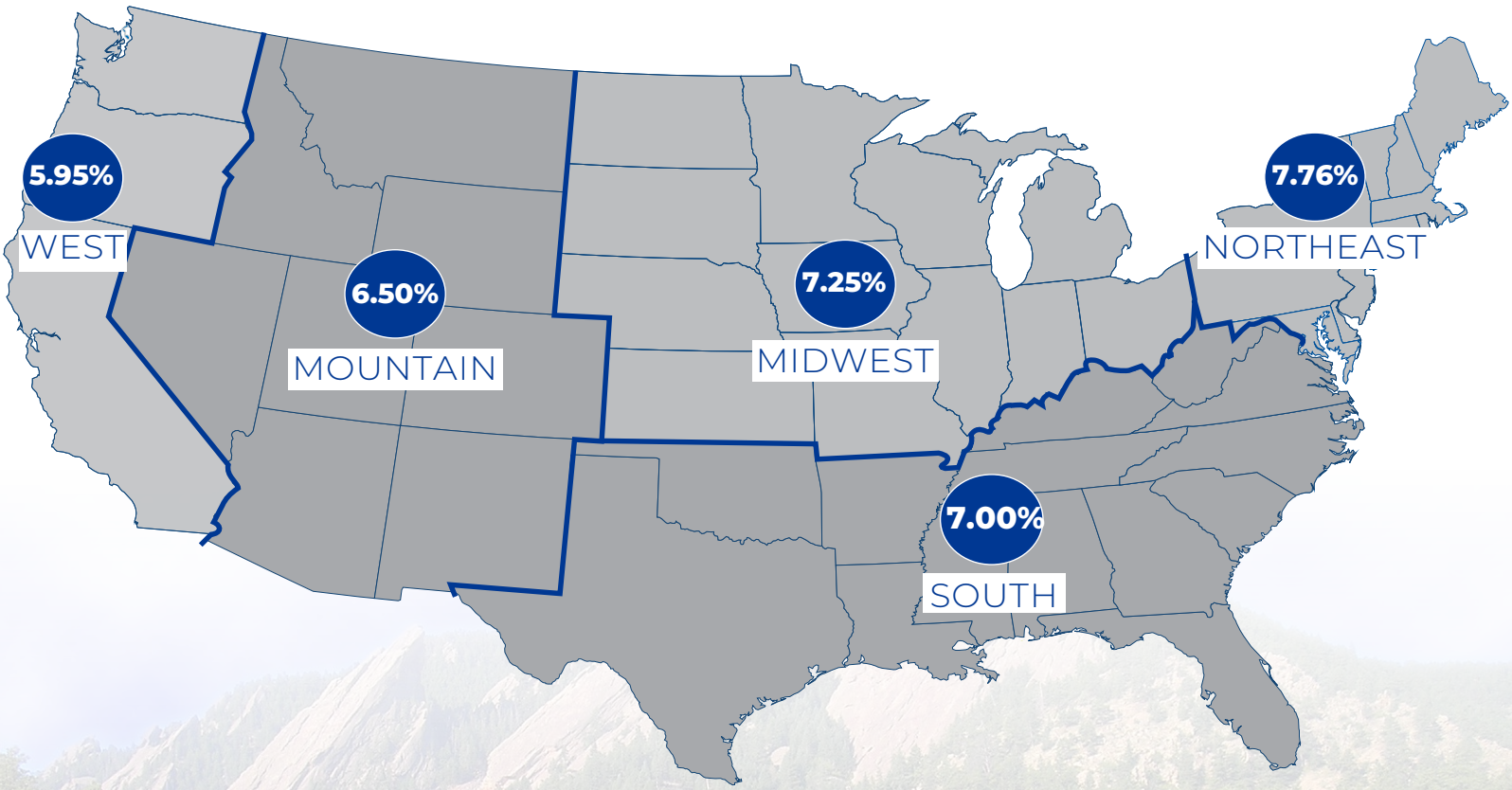
MEDIAN ASKING CAP RATES BY SQUARE FOOTAGE

Sector	SF Range	Cap Rate	Percentage of Market
Junior Big Box	20,000 - 40,000	7.29%	44%
Mid Box	40,000 - 80,000	6.99%	42%
Large Format	Over 80,000	6.75%	14%

MEDIAN ASKING CAP RATE BY LEASE TERM REMAINING

Years Remaining	Investment Grade	Non-Investment Grade
16-20 Years	5.25%	6.50%
11-15 Years	6.00%	6.85%
6-10 Years	6.65%	7.50%
5 Years & Under	7.13%	8.25%

BIG BOX MEDIAN ASKING CAP RATE BY REGION



SELECTED SINGLE TENANT BIG BOX CLOSED TRANSACTIONS

Sale Date	Tenant	City	State	Price	Price/SF	Cap Rate	Lease Term Remaning
Dec-19	Cabela's	Hamburg	PA	$55,218,045	$227	6.65%	25
Oct-19	Fleet Farm	Sioux City	IA	$37,300,000	$171	7.85%	19
Nov-19	Home Depot	Grand Rapids	MI	$22,555,000	$218	5.80%	10
Nov-19	Lowe's	Concord	NC	$15,150,000	$112	6.09%	10
Oct-19	Burlington	North Richland Hills	TX	$11,900,000	$168	7.02%	9
Nov-19	LA Fitness	Cedar Park	TX	$10,642,276	$313	6.15%	15
Dec-19	At Home	Kennewick	WA	$10,450,000	$98	7.12%	10
Oct-19	Hobby Lobby	Pearland	TX	$9,545,000	$173	6.05%	14
Dec-19	Harkin Theatres	Tucson	AZ	$8,475,000	$186	8.06%	9
Nov-19	Academy Sports	Starkville	MS	$8,378,000	$133	7.60%	15
Oct-19	LA Fitness	Maplewood	MN	$8,185,150	$226	6.75%	9
Dec-19	Camping World	Tyler	TX	$7,385,000	$157	7.25%	17
Dec-19	Planet Fitness	Salem	OR	$4,880,000	$209	7.59%	10
Oct-19	La-Z-Boy	Las Vegas	NV	$4,700,000	$227	6.60%	6

COMPANY COMPARISON

Tenant	Total Number of Stores	Credit Rating
24 Hour Fitness	400+	B-
Academy Sports + Outdoors	290	Not Rated
Albertsons	2,260	B+
Bed Bath & Beyond	1,550	BB
Best Buy	997	BBB
BJ's Wholesale	216	B+
Dick's Sporting Goods	850	Not Rated
Hobby Lobby	822	Not Rated
Kohl's	1,158	BBB
Kroger	3,014	BBB
LA Fitness	700+	Not Rated
Lowe's Home Improvement	2,002	BBB+
Petco	1,500	CCC+
PetSmart	1,500	B-
Ross Dress for Less	1,483	A-
Staples	1,220	B+
TJMaxx	1,241	A+
The Home Depot	2,285	A
Walmart Stores	11,438	AA
Whole Foods Market	500	A+

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Commercial Mortgage Bridge Loans

A SOLID FINANCIAL PRODUCT:

- 6% for 12 months
- 7% for 18 months
- First position lien
- Interest paid each month and full principal returned at the end of the term
- These products can be purchased inside or outside of Self Directed IRA account



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Appendix 3

Commercial Mortgage Bridge Loans fund high quality real estate projects.



HOTELS | APARTMENTS | OFFICE BUILDINGS | SHOPPING CENTERS | MEDICAL BUILDINGS

- You receive 6% - 7% per year, paid monthly by direct deposit. Your principal is returned in full at the end of the cycle.
- Easy to reapply your principal to another mortgage loan when your existing loan is paid off by the borrower.
- You are placed in First Position on all Commercial Mortgage Bridge Loans so your loans are fully secured with your name filed in the public land records.
- Timely interest payments of all interest and principal to you will be paid by the company assembling the deal, a Multi Million Dollar Mortgage Fund.
- Your principal never fluctuates in value and is unaffected by the gyrations of the stock or bond market.
- You never pay any commissions, management fees or asset charges—100% of your money gets the full 6% - 7%.
- Commercial Mortgage Bridge Loans can be purchased inside a self directed IRA account.

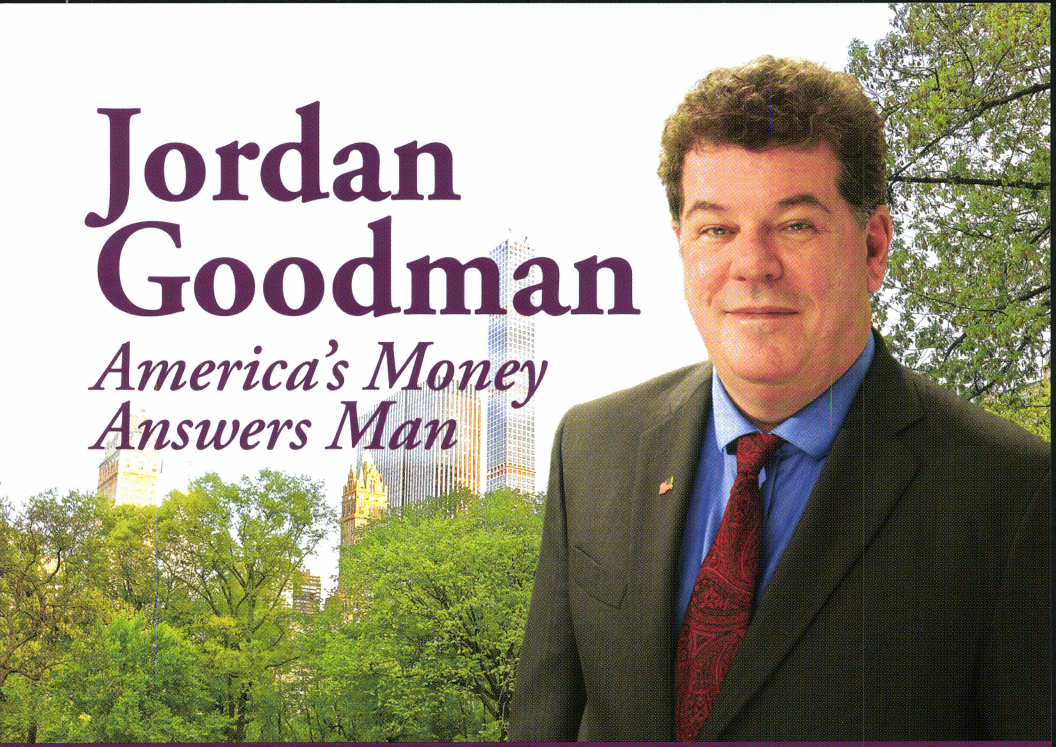
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- Appeared on The View, Fox News Network, Fox Business Network, CNN, CNBC and CBS Evening News
- On Money Magazine editorial staff for 18 years
- Author of 14 best selling books and Co-Author of "Barron's Dictionary of Finance and Investment Terms"

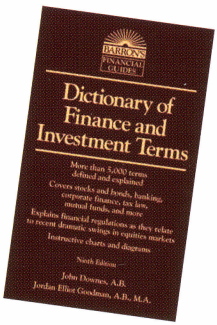
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Jordan Goodman
"America's Money Answer's Man"

Jordan E. Goodman is "America's Money Answers Man" and a nationally-recognized expert and speaker on personal finance. He is a regular guest on numerous radio and television call-in shows across the country, answering questions on personal financial topics. He appears frequently on The View, Fox News Network, Fox Business Network, CNN, CNBC and CBS Evening News.

For 18 years, Jordan was on the editorial staff of Money magazine, where he served as Wall Street correspondent. While at Money, he reported and wrote on virtually every aspect of personal finance. In addition, he served as weekly financial analyst on NBC News at Sunrise for 9 years and the daily business news commentator on Mutual Broadcasting System's America in the Morning show for 8 years.



He is the author / co-author of 14 best-selling books on personal finance including Master Your Debt Fast Profits in Hard Times, Everyone's Money Book, Master Your Money Type, Barron's Dictionary of Finance and Investment Terms and Barron's Finance and Investment Handbook.

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5% YIELD
for one year?
The First Position
Commercial Mortgage
is a BETTER solution
for your money.

Appendix 4

Why PARTNER with Woodbridge?

With a management team that has over 35 years of experience in offering financial opportunities, our hard-earned reputation for reliability and service is second to none. We provide our valued clients with a steady stream of superior financial products.

Woodbridge realizes the higher yield potential of First Position Commercial Mortgages (FPCMs) because of our extensive experience with commercial loans, first mortgages, and real estate acquisitions. We maintain a highly successful lending model, built on years of handling large-scale commercial mortgages.

In today's uncertain environment, we offer safer alternatives to help our clients reach their financial goals. For private lenders seeking to earn higher fixed annual yields with the assurance that their funds are secured by commercial real estate, Woodbridge has the solution.

FPCM OPPORTUNITY

Picture a unique lending opportunity with higher yields that is simpler, safer, and more secured. That is exactly what First Position Commercial Mortgages can achieve.

Woodbridge funds 1-year bridge loans to commercial property owners. Each bridge loan is secured by a valuable hard asset—the subject property itself. Each property holds a low loan-to-value (LTV) ratio. That means the property that secures these FPCMs are worth more than the loans themselves at closing.



WOODBRIDGE WEALTH

THE ADVANTAGES of FPCMs

As a private lender, you are recorded on title and acquire a first lien position on these notes. Lenders are paid immediate monthly interest payments at a fixed annual yield of five percent (5%) for 1 year.

We are so confident in these notes that Woodbridge partners with you by lending our own funds and holding a second lien position behind your first lien position. Woodbridge contractually obligates itself by Promissory Notes and Loan Agreements to pay the monthly interest payments and return the principal at the end of the term.



FPCM PROPERTY EXAMPLE

Northborough Drive—Houston, TX

APPRAISED VALUE	$4,000,000
FIRST LIEN POSITION	$1,350,000
SECOND LIEN**	$150,000
LOAN-TO-VALUE	34%
TERM	12 MONTHS
LENDER PRICE	$50,000
INTEREST RATE	5%
MONTHLY INTEREST	$208.33

**Woodbridge holds the second lien position on all properties.

How does Woodbridge PROTECT PRIVATE LENDERS?

ASSESSMENT► Woodbridge thoroughly evaluates each property by conducting a comprehensive appraisal to confirm market value, and a title search is performed to make sure that lenders receive a first lien position.

BACKING► As your partner and the second position lien holder, Woodbridge is obligated to make interest payments to lenders, regardless of the status of the underlying loan.

COLLATERAL► With loan-to-value ratios of 60% or less, the property's equity is your collateral.

Short term, dynamic growth in a SECURED PRODUCT

- Short term of 1 year
- Fixed annual yields of 5%
- Immediate monthly payments
- Secured by commercial real estate
- Recorded first lien position
- Woodbridge is your partner

Woodbridge offers lenders PEACE OF MIND

- Our management team has over 35 years of unsurpassed experience and reliability
- Proven ability to find attractive financial opportunities
- Performance and stability

Choose the opportunity that is RIGHT FOR YOU

As a private lender, Woodbridge will provide you with available lending opportunities on a daily basis. These feature an array of properties nationwide that may range from $50,000 to $5,000,000. Select the one that works best for you and helps you achieve your financial goals.

Get started now.

800-506-1641

WoodbridgeWealth.com



The Power of First Position Commercial Mortgages

WOODBRIDGE WEALTH

Why partner with Woodbridge?

- Our management team has 35 years of experience in offering financial opportunities.
- Reputation for reliability and service is second to none.
- Provide clients with a steady stream of superior financial products.
- Our clients understand that in today's uncertain environment, we offer safer alternatives to help them reach their financial goals.



First Position Commercial Mortgages

WOODBRIDGE WEALTH

First Position Commercial Mortgage opportunity



Picture a unique lending opportunity with higher yields that is simple, safer and secured. That is exactly what First Position Commercial Mortgages (FPCM) can achieve.

A First Position Commercial Mortgage is a private third-party loan to Woodbridge that is secured by commercial real estate. Private lenders select a commercial mortgage in Woodbridge's inventory to serve as collateral for their private loan. They are recorded on title and acquire a first lien position on the mortgage, and Woodbridge pays each lender immediate monthly interest payments at a fixed annual yield, with a return of principal at the end of the one year term.



Woodbridge commercial mortgages

Because our management team has 35 years of experience with commercial loans, first mortgages and real estate acquisitions, Woodbridge maintains a highly successful lending model built on years of handling large-scale commercial mortgages.

First Position Commercial

- Exclusively Commercial Loans
- Short Term of 1 Year
- Low Loan to Value (LTV) Ratios
  Fixed Annual Yields
- Immediate Monthly Payments
- Secured by Commercial Real Estate
- Recorded First Lien Position
- Proven Ability to Find Attractive Financial Opportunities
- Performance and Stability
- Woodbridge is Your Partner

WOODBRIDGE WEALTH

What does it mean to be "First Position" in a Woodbridge Commercial Mortgage?

- Having a first position means that you have the first lien position recorded on title on of the property that secures the mortgage.
- The first lien has priority over any other liens or claims on a property in the event of default.
- Woodbridge pays off any existing lienholders when it enters into a transaction with a borrower, so there are no additional liens on the property.
- If the borrower defaults, Woodbridge is contractually obligated to make the payments to the lender regardless of the status of the underlying loan or borrower's ability to pay.

WOODBRIDGE WEALTH

Our due diligence

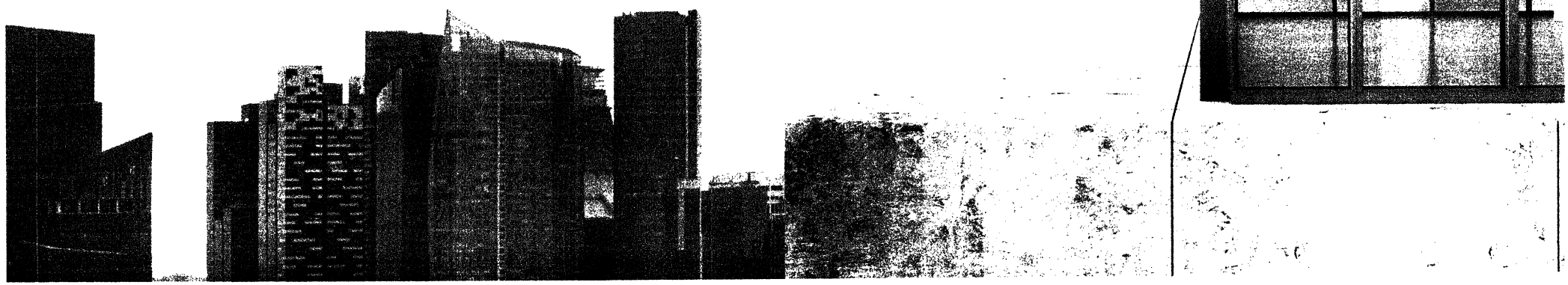
- Woodbridge conducts rigorous due diligence when making lending decisions, ensuring that the property is free of liens.
- A complete title search is performed to make sure there is an insured first lien position.
- A comprehensive appraisal is conducted by licensed, certified and bonded appraisers, along with a Broker Price Opinion (BPO), to confirm the market value.
- If requested, Woodbridge will provide copies of the title policy and/or appraisal.



WOODBRIDGE WEALTH

Benefits of First Position Commercial Mortgages

- Earn a secured yield as high as 5%.
- Lender's funds are protected by hard collateral that has significant value.
- Short and flexible loan terms.



WOODBRIDGE WEALTH

Best benefit overall



We are so confident in these notes that Woodbridge partners with lenders by lending our own funds and holding a second lien position behind their first lien position. Woodbridge contractually obligates itself by promissory notes and loan agreements to pay the monthly interest payments and return the principal at the end of the term.

WOODBRIDGE WEALTH

Mitigating the risks for clients

Three Layers of Collateral—With loan-to-value ratios of 60% or less, the property's equity is a lender's collateral:

1. **Promissory Note:** This document is Woodbridge's contractual promise to repay its lender according to the agreed terms and conditions set forth in both the Promissory Note and Loan Agreement. The Promissory Note forms the basis of a lender's right to payment from Woodbridge according to its terms.

2. **Loan Agreement:** The Loan Agreement creates and attaches a security interest in the lender-selected collateral in favor of that lender.

3. **Assignment and Collateral Assignment:** These documents are a pledged conveyance by Woodbridge of all of its rights, title, and interest as holder and owner of the selected commercial note and mortgage loan instruments and proceeds.

WOODBRIDGE WEALTH

Types of properties

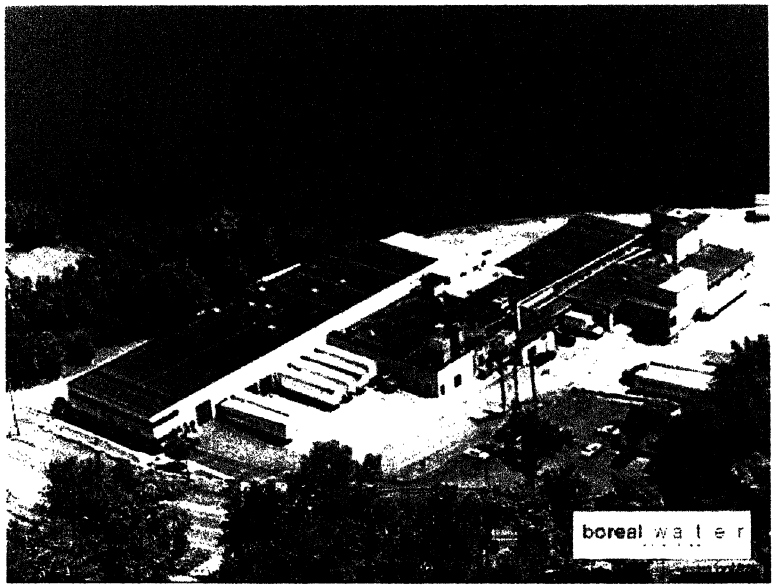
Generally these properties are commercial real estate, including multi-unit apartment buildings, mixed-use developments, or any other kind of commercial project, as well as non-owner occupied, single-family homes held as investment properties by corporations or limited liability companies.



Let's take a look at the actual inventory

WOODBRIDGE WEALTH

Property example #1



Water Bottling Plant—Kiamesha, New York

Appraised Value:	$2,000,000.00
First Lien Position:	$800,000.00
Second Lien Position: (retained by Woodbridge)*	$100,000.00
Minimum Purchase:	$50,000.00
Term:	12 months
Loan to Value Ratio (LTV):	40%
Lender Price:	$50,000.00
Interest Rate:	5%
Monthly Interest:	$208.33

*Woodbridge holds the second lien position on all properties.

WOODBRIDGE WEALTH

Property example #2



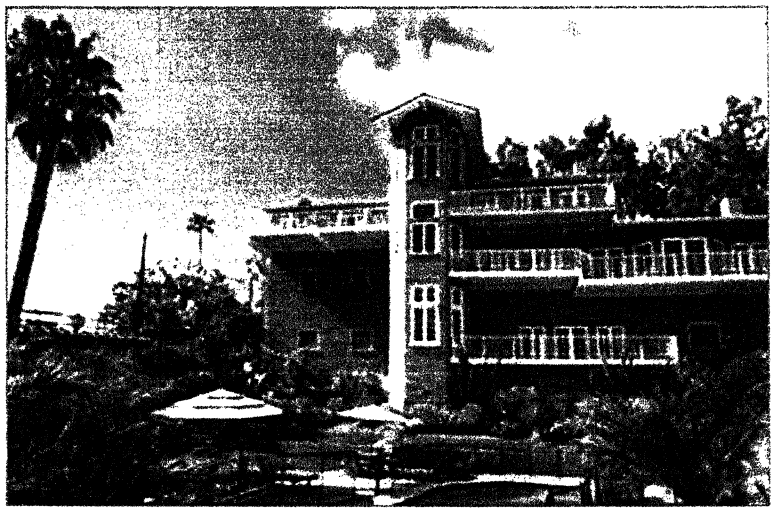
Retail bldg. (Bowling Alley)—Union City, GA

Appraised Value:	$2,210,000.00
First Lien Position:	$750,000.00
Second Lien Position: (retained by Woodbridge)*	$100,000.00
Minimum Purchase:	$50,000.00
Term:	12 months
Loan to Value Ratio (LTV):	34%
Lender Price:	$75,000.00
Interest Rate:	5%
Monthly Interest:	$312.50

*Woodbridge holds the second lien position on all properties.

WOODBRIDGE WEALTH

Property example #3



Single Family—Beverly Hills, California

Appraised Value:	$3,100,000.00
First Lien Position:	$1,910,000.00
Second Lien Position: (retained by Woodbridge)*	$190,000.00
Minimum Purchase:	$50,000.00
Term:	12 months
Loan to Value Ratio (LTV):	62%
Lender Price:	$100,000.00
Interest Rate:	5%
Monthly Interest:	$416.66

*Woodbridge holds the second lien position on all properties.

WOODBRIDGE WEALTH

Property example #4



Land Lot—Kihei, Hawaii

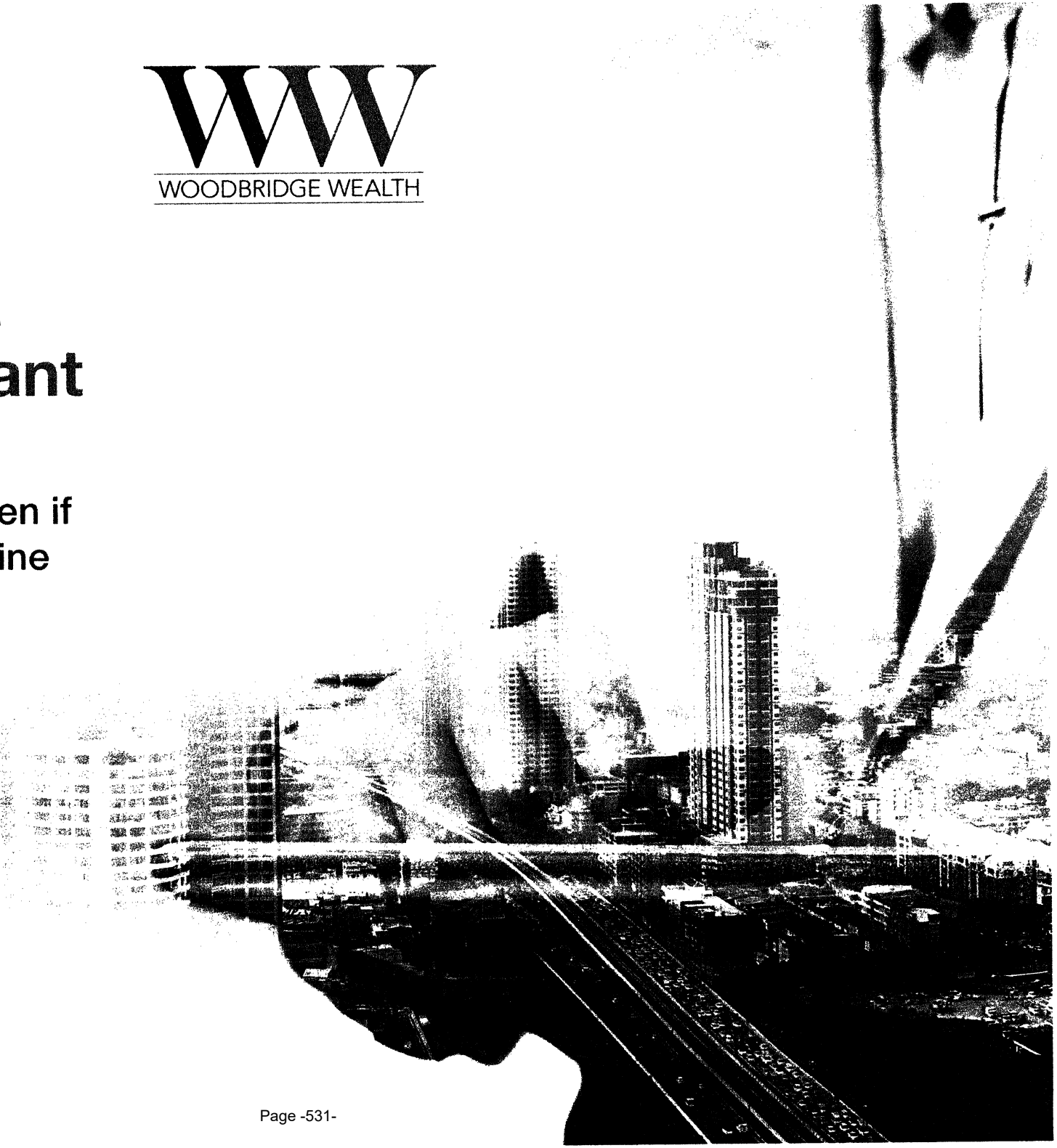
Appraised Value:	$14,000,000.00
First Lien Position:	$3,400,000.00
Second Lien Position: (retained by Woodbridge)*	$400,000.00
Minimum Purchase:	$50,000.00
Term:	12 months
Loan to Value Ratio (LTV):	24%
Lender Price:	$200,000.00
Interest Rate:	5%
Monthly Interest:	$833.33

*Woodbridge holds the second lien position on all properties.

WOODBRIDGE WEALTH

Positioning is most important

- Strong LTV's help to protect your loan, even if property values decline
- Short term duration
- First Lien position



WOODBRIDGE WEALTH

How it works

What Type Of Funds Can I Use For Lending?

Lenders can use qualified or non-qualified funds, an IRA, Trust, LLC, Pension, 401k or lend in their own name.

Does Woodbridge Charge Any Fees?

There are no transaction fees or commission for lenders to pay, EVER.

100% of their deposit goes to work for them IMMEDIATELY!

WOODBRIDGE WEALTH

Benefit recap

- Exclusively commercial loans
- Short term of 1 year
- Low Loan-to-Value (LTV) ratios
- Fixed annual yields of 5%
- Immediate monthly payments
- Secured by commercial real estate
- Recorded first lien position
- Woodbridge is your partner
- Our management team has 35 years of unsurpassed experience & reliability
- Proven ability to find attractive financial opportunities
- Performance and stability

WOODBRIDGE WEALTH

How can I get started?

If you'd like to start purchasing one of our available First Position Commercial Mortgages:

- Request assistance from a Woodbridge Consultant at (866) 941-8631.
- Or go to www.WoodbridgeWealth.com.
- Click on "Opportunities Available" at the top of the page, under the First Position Commercial Mortgages dropdown.
- Scroll down to view available inventory.
- Click the "RESERVE" button next to any of the available properties in the "Offers Ready for Closing" or "Offers Preparing for Closing" sections, each are available for purchase.

SMITHSON FINANCIAL

A Shield for Your Retirement and Assets

WOODBRIDGE WEALTH

Are you earning a

6% YIELD

for one year?

- Your Principal and interest are 100% secured
- Interest is paid out monthly (beginning within 30 days)
- No long term commitments – short durations of 12 months
- This is NOT and insurance product
- This is NOT an annuity
- This is NOT risky stocks, options, or REITS
- This is NOT Gold, Silver or any other commodities
- 100% of your money goes to work immediately (NO additional fees)

PREFERRED BROKER RATES

$25,000 - $49,999	=	5.0%
$50,000 - $99,999	=	6.0%
$100,000 - $199,999	=	6.5%
$200,000 and up	=	7.0%

Todd Smithson – 801-830-3181

email: saferetirements@gmail.com

Unlock the profits of a First Position Commercial Mortgage Note (FPCM) (Sometimes called Secured Bridge Loans)

This product has unique safety features which provide lenders a range of benefits.



WOODBRIDGE WEALTH

First Position Commercial Mortgages FAQs

1. What is a First Position Commercial Mortgage?
A First Position Commercial Mortgage is a private third-party loan to Woodbridge that is secured by commercial real estate. Private lenders select a commercial mortgage in Woodbridge's inventory to serve as collateral for their private loan. They are recorded on title and acquire a first lien position on the mortgage, and Woodbridge pays each lender immediate monthly interest payments at a fixed annual yield, with a return of principal at the end of the one year term.

2. Why are they called First Position Commercial Mortgages?
The phrase "First Position Commercial Mortgage" describes the collateral pledged by Woodbridge as security for the loan you are making. As a private lender, you select a particular commercial mortgage from Woodbridge's inventory to serve as collateral for your loan to Woodbridge. A First Position Commercial Mortgage loan is not a mortgage investment pool and it is not a direct investment in real estate. They may also be referred to as First Trust Deed Loans or Senior Interest Position Mortgages.

3. What is a first position in a commercial mortgage?
As a commercial mortgage lender, Woodbridge executes only first mortgage transactions with commercial borrowers ensuring we hold the first lien on the property. If you have a first position, that means you have priority over any other liens or claims on a property if the property owner defaults.

4. With interest rates so low, why do borrowers come to Woodbridge?
Unfortunately, banks are not lending the way they used to. In today's lending environment, real estate developers and commercial borrowers are seeking out alternative financing that they can receive in 2 to 3 weeks, which Woodbridge provides. We offer short-term bridge loans to commercial property owners based on the value of their property. The borrowers qualify for our mortgages because they are secured by the high value commercial assets.

5. What types of property are used as collateral in these transactions?
Generally, Woodbridge secures these mortgages with commercial real estate, such as multi-unit apartments, office buildings, retail centers or mixed-use developments; though we will sometimes accept as collateral non-owner occupied, single-family homes that are held as investment properties and owned by a corporation or limited liability company.

6. What are some of the terms of the mortgage given to the borrower?
Our commercial mortgage lending policies dictate that we lend for a maximum loan term of two years and up to only 70 percent of the value of the real estate. That means the properties that secure the mortgages are worth considerably more than the loans themselves at closing.

7. What type of due diligence does Woodbridge perform on these properties?
Woodbridge performs a title search to make sure we have an insured first lien position and thoroughly evaluates each property by conducting a comprehensive appraisal to confirm market value.

8. Are the properties insured?
Woodbridge obtains insurance coverage on the encumbered property. This mitigates the risk of loss to the property's value due to damage, destruction, natural disasters (earthquake, flood, tornado, hurricane, mudslide), and the like.

9. What is a lender's collateral?
With loan-to-value ratios of 60% or less, the property's equity is your collateral.

10. What is the paperwork required to get started?
When you lend on a First Position Commercial Mortgage, you enter into a Promissory Note and Loan Agreement that set the terms under which Woodbridge repays you.

WOODBRIDGE WEALTH

First Position Commercial Mortgages FAQs

11. How am I better protected from downside risk?
Your loan is secured by a hard asset collateral—the property itself. Additionally, Woodbridge participates by lending confidently alongside lenders and holds a second lien position on all commercial mortgages.

12. How does Woodbridge establish that the property has no additional liens?
Woodbridge pays off any existing lienholders when it enters into a transaction with a borrower so there are no additional liens on the property. Additionally, Woodbridge obtains a title policy for each property.

13. How do I verify that I hold a first lien position in the mortgage?
Upon request, Woodbridge will provide you with a copy of the title policy which indicates there are no other liens or claims above you.

14. Will my name appear on the land records of the property?
Yes. Woodbridge executes and delivers the first lien position documents in your name and files the documentation on the land records in the relevant jurisdiction.

15. Does the borrower make payments to me?
No. Woodbridge is contractually obligated to make your monthly interest payments and return the principal at the end of the term, regardless of the status of the underlying loan.

16. What happens if the borrower does not make payments or defaults?
First Position Commercial Mortgage loans are private transactions that are separate and distinct from the pledged collateral. As such, Woodbridge's obligations to you are neither contingent upon nor subject to the performance or repayment status of the underlying commercial mortgage. If a commercial borrower does not make its payments to Woodbridge or defaults, Woodbridge remains obligated and shall continue to pay your monthly interest payments and return your principal at the end of the term according to the terms of your Promissory Note and Loan Agreement.

17. How am I taxed on a First Position Commercial Mortgage?
You should consult a tax advisor or accountant for tax-related questions specific to your situation; however, the IRS typically taxes payments on first lien position interest holdings as ordinary income. Woodbridge will provide a Form 1099 for all lenders.

How do I get started?

If you'd like to get started on purchasing one of our available First Position Commercial Mortgages:

- **Call a Woodbridge Consultant at (866) 941-8631, or**
- **Go to www.WoodbridgeWealth.com.**
  1) **Click on "Available Offers" and view inventory**
  2) **Click the RESERVE button next to any of the available properties in the "Offers Ready for Closing" or "Offers Preparing for Closing" sections. Each are available for purchase.**

Sycamore Group, Inc.

10419 CORY LAKE DRIVE, TAMPA, FL 33647 (888) 777-8685
wallymackey@wallymackey.com

Dear William Spirka:

Here's the bottom line! I have 1,800 clients, and no one has ever lost any money, paid any fees, or paid any commissions. Since 1997 my proprietary strategies have outperformed the stock market by 2:1. That's a record worth considering!

My DVD offers an alternative for investors seeking safety. This strategy pays an annual interest rate linked to the gains of a stock market index. The worst case scenario is a zero rate should the index decline, but I have earned double-digit rates in a rising stock market. New clients receive a cash incentive bonus up to 12%. With the Federal Reserve's "Near Zero Interest Rate" and "Quantitative Easing (printing money)" policies, Economist Harry S. Dent's new 2016 book warns investors of a 2017 crash in stocks, mutual funds, commodities and bonds!

Another safe alternative is a renewable 12-month contract paying a 5% to 7% annual yield with a minimum $100,000. The interest is paid monthly with the principal returned at the end of 12 months, unless it is rolled over into a new 12-month contract. Since 2007, the administrator (rated A+ by the Better Business Bureau) has issued tens of thousands of these contracts, and no one has ever lost any money! Listen to my audio CD for details.

The "Wally Mackey's Success Story" appeared in *Forbes, Bloomberg Business Week, Fortune,* and *Money* magazines several times. It's a story about how my wife and I became multi-millionaires using the same strategies recommended to clients. In December my success story will appear in the Wall Street Journal.

When you are ready to work with me, call 888-777-8685 for an appointment to meet in the privacy of your own home. No one will call you! Michigan clients will meet with my daughter, Tamara Christians, RFA®, at her downtown Grand Rapids office. It's time to protect your retirement!

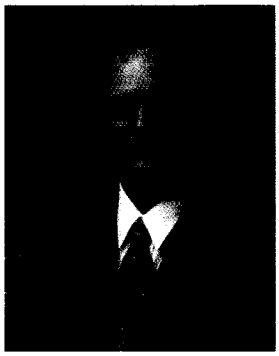
Wally Mackey, RFC®
Registered Financial Consultant®

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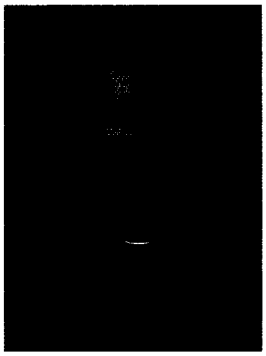
FLORIDA
FINANCIAL LEADERS
As Seen In... Forbes, June 30, 2014

Wally Mackey's Success Story

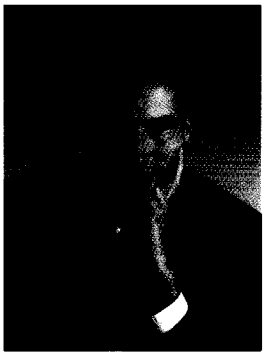
President, Sycamore Group Inc.



Wally Mackey, RFC®



Tamara Christians



Harry S. Dent

When Wally Mackey became a financial planner, he immediately discovered a problem. He had been trained to sell products he wouldn't buy himself: mutual funds and variable annuities.

Realizing that clients often rode an investment gains-and-losses roller-coaster – and driven by the need to put his own financial house in order – Mackey created a way to climb out of debt, avoid fees, protect against losing money and amass millions for retirement. That's what he and his wife did.

"If you want to be successful, then do what I've done."

—Wally Mackey, President, Sycamore Group Inc.

He designed new financial strategies, which he later trademarked as "Money Strategies Using Something Guaranteed Safe®." It's an approach designed to provide a high rate of success, according to Mackey.

A Teacher

Mackey acknowledges he's not a traditional financial planner. Instead, he teaches people how to be their own financial advisers. He introduced his approach in a 1998 booklet titled *Retirement Planning: A Complete Guide to Your Retirement Years by Surviving the Baby Boomers' New Toy – the Stock Market.* He trademarked it "Financial Planning for the Rest of Your Life®."

"The basic idea of what I'm doing is I'm putting people in a safe product – you just don't lose money," Mackey says. "If you want to be successful, then do what I've done. I've got 1,800 clients. I've never lost a client. They make money."

Now, to bring continuity to the company, Mackey has welcomed his daughter, Tamara Christians, into the business. She will serve clients both in Tampa and in Grand Rapids, Michigan, where she lives.

For the past five years, **Sycamore Group Inc.** has earned the Best of Tampa Award in the Retirement Planning Consulting Service Category from the U.S. Commerce Association.

One-on-One Sessions

Mackey teaches his unique, copyrighted approach through personal, one-on-one training sessions. The steps necessary for a safe retirement use economist Harry S. Dent's economic forecasts. As a Lifetime Charter Member with a Master Certification from the Dent Research Network, Mackey is licensed to present a financial strategy with a record of success.

"Anyone can sell you a financial product," he says. "Then what? To be financially independent, you must know how to manage your own money. It's your money, your retirement plan and your responsibility to be successful. As a teaching adviser, I train people how to be as successful as my family. It's so easy, thousands have already succeeded."

Go to www.wallymackey.com or call 800-217-1556 for a free information kit. This offer is valid for permanent residents of Florida, Illinois, Minnesota and Michigan. Wally Mackey makes no recommendations regarding the purchase or sale of any security. Over 10,000 individuals have benefited from an approach Mackey calls America's most profitable retirement plan.

SYCAMORE GROUP INC.

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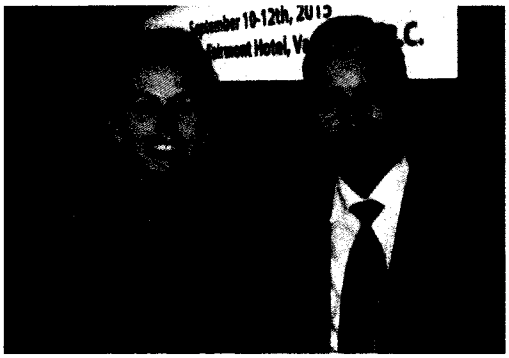
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MONEY STRATEGIES USING SOMETHING GUARANTEED SAFE®
FINANCIAL PLANNING FOR THE REST OF YOUR LIFE®

RETIRMENT INCOME PLANNING WITH GUARANTEED SAFE STRATEGIES EARNING 5% TO 7% YIELDS!

EDUCATIONAL PRESENTATION FROM THE
"WALLY MACKEY INSTITUTE FOR ADVANCED RETIREMENT PLANNING™"





Wally Mackey, RFC® Tamara Christians, RFA® Harry S. Dent, Jr.

SYCAMORE GROUP INC.
10419 Cory Lake Drive, Tampa, FL 33647
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Wally Mackey and Tamara Christians, his daughter, are Lifetime Charter Members with a Master Certification in Economic Forecasting from H.S. Dent Research Network; as well as, Members of the Better Business Bureau, Financial International Association of Registered Financial Consultants, National Ethics Association, Financial Planning Association, and a licensed life insurance and annuity providers. They are not security licensed.

This document is intended to educate the reader on retirement planning recognizing the economic factors in the current market conditions. The information is deemed accurate and authoritative in regards to the subject matter covered. Nothing in this report should be deemed investment advice, tax advice, or a recommendation to buy or sell stocks, bonds, mutual funds or variable annuities. This report is an advertisement to invite an inquiry for more details. Unauthorized use of the company's trademarks or reproduction of this report is prohibited. Every client candidate will be provided a personalized complimentary retirement plan after the completion of the training program. For more information of Economist Harry S. Dent's demographic-based economic forecasts, logon http://www.dentresearch.com for his free newsletter offer and video presentations.

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5% TO 7% RETURNS ON RETIREMENT MONEY!

I remember watching my mother flip through the newspaper looking for bank advertisements stating their current CD interest rates. At the time my parents had a pension fund from my father's employer, Republic Steel, and my mother's employer, the Warren Ohio School System. When added to their social security, they lived comfortably. The CD money paid for the extras, like Christmas gifts and trips to Disney. They never worried about the stock market or bonds! Earning 5% to 7% at the bank gave them comfort and security. It worked for decades! That's how middle-class retirees managed their retirement in the 1970s!

During the mid-1990s everything changed with the introduction of mutual funds, and many people flocked to them. I had just become a financial planner. While attending a seminar presented by Economist Harry S. Dent, I learned forecasts of the pending "Boom and Bust Cycles (1995-2023)." Dent said, "Investors will make and lose money over and over again. As a result of this information, I never sold any securities; rather, I created the trademark, "Money Strategies Using Something Guaranteed Safe®. The strategies use the little known "Fixed Indexed Annuity" where the yield is linked to the gains of a stock index without losing any money! The "Wally Mackey Success Story" has been published in Money, Forbes, Fortune, and Bloomberg Business Week magazines. Supported by my wife, Chris, we became multi-millionaires earning an average annual 5% to 7% interest rate.

The common reactions to my approach is: (1) I can make more money invested in the stock market, and (2) nobody pays a 5% to 7% interest rate! You are going to learn that both reactions are wrong!

READY FOR YOUR RETIREMENT YEARS?

The unfortunate reality is a vast majority of Baby Boomers don't have enough money saved to maintain their current standard of living, and most don't have pensions of any kind, like their parents did! To make up the difference, most claim they'll keep working past retirement age, giving them the income they need for their lifestyle as well as peace of mind. It's easy to say, particularly when you are years away from actually retiring, but following through becomes harder as you age. And, it's not because we change our minds. Often, the outside world has a different idea of what should happen next.

Strong Uptrends and Downtrends in Births

	Uptrends	Downtrends
Bob Hope Generation	1909-1914	1917-1919
	1920-1921	1924-1933
Baby Boomers	1937-1943	1944-1945
	1946-1947	1948-1950
	1951-1957/61	1962-1968
	1969-1970	1971-1973/76
Echo Baby Boomers	1977-1990	1991-1996
	1997-2007	2008-

Up until 2008, the Baby Boomers occupied most of the working force. Today, the realty has changed as the Echo Boomer Generation becomes old and competitors to the Baby Boomers. Starting in 1977, the children of Baby Boomers began the second largest generation. In 2016, the first Echo Boomer is now age 39 years old. If you are a Baby Boomer, age 55, and plan to work until age 70, you need to understand the increasing number of Echo Boomers will have reached their most productive age during their 40s.

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According to the Transamerica Center for Retirement Studies, Americans think they need to save around $600,000 for retirement. Given that those who reach retirement age can expect to live another 20 years, this may seem reasonable. But, there is one giant problem; almost **no one has** saved that much money! The median retirement savings is $135,000. The average Baby Boomer struggled to accumulate $135,000 over the last 30 years. To get to $600,000, they will need to accumulate another $465,000 – a stretch of the imagination of most Baby Boomers.

No matter what the reason, the reality is that an overwhelming majority of Older Workers and retirees appear to have nowhere near the resources they need to maintain their lifestyle through retirement. The sad part is that both Older Workers and retirees appear to be delusional about their situation.

MOST FINANCIAL STRATEGIES WILL FAIL!

The vast majority of Baby Boomers are counting on generating gains within their investments in a 401k, 403b, IRAs, and other retirement accounts. Today, I received a call from a 55-year old delusional Baby Boomer, telling me about how he is earning double-digit returns on his investments. I asked, "Why are you calling me? Double-digit returns sound good to me!" His reply, "Well, I am not married to (the company holding his investment). And, I am paying fees and commissions!" – something my clients do not pay. Again, I asked, "But, my recommendation pays a 5% to 7% yield with a $100,000 minimum without any fees or commission costs. Why are you calling me? Double-digit returns sound better even though you have investment costs!" Finally, he said, "Because I am worried about losing money again!"

A 5% TO 7% YIELD IS BETTER THAN LONG-TERM INVESTMENTS!

Most people are holding investments believing they are actually earning the return proposed by their financial planner five years ago. Financial advice given in the late 1990s was completely wrong when stock prices were rising rapidly and people were making 20-25% annual returns. Planners were telling people it was okay to withdraw 10% from their accounts because (after all) they were making so much money! Similar misrepresentations (you can withdraw 4%) are being given today. The fact is no one knows for sure!!!

The problem with stock market investing is the "Boom and Bust Cycles." No one paid much attention to Harry Dent's forecasts, and in 2000 the "Tech Stock Bubble" burst as he had forecast. Financial planners and the financial brokerages made money and everyone else lost massive amounts. Investors talked about it for years!

Then, in 2007, most investors had recovered their losses. The stock market was deemed a safe place once again, and people were told to withdraw 5% of their investments to supplement their social security income, even though Dent had forecast the "Boom and Bust Cycles" would

continue through 2023. Again, no one believed him. Then, the stock market crashed in 2008 and continued until late 2009 when the Federal Reserve introduced an "Unnatural Interference" into the economy, known as "Quantitative Easing (QE)" and "Near-Zero Interest Rates."

QE was the process of buying bad mortgages using new dollars created out of thin air. This money was deposited with major banks to make loans as a "stimulus" to the economy. But, the banks never followed the "Stimulus Plan." Rather, they passed the money to their stock brokerages. Almost to the day, stock prices rose and continued to rise as the Federal Reserve pumped more and more "thin air" money into the banks. Today, we are looking at another stock market bubble. Only this time, the bubble is worldwide, interest rates are still historically low, and the financial planning industry continues to give bad advice.

With the global stock markets reaching all-time highs, it might seem as if there's nothing but blue skies ahead. That's not the case! With economic growth stuck in first gear and central banks around the world trying to figure out how to jumpstart their economies, we still face a host of economic woes. Later in this report I will explain! The fact is U.S. stock prices have risen in spike of the declining economy. The greatest concern is the private and public debt.

As expected, the Federal Reserve held interest rates steady, leaving the overnight rate in the range of 0.25% to 0.50%. That means interest rates will remain low. British voters chose to leave the European Union, sending the financial world into a tizzy. Few expected the result, and almost no one had developed a plan as to how the country would extricate itself from the economic bloc.

As people came to grips with the new world view, the Federal Reserve stood firm, waiting for calmer times. As the days passed and financial market didn't implode, investors got more comfortable with the Brexit vote. Things returned normal when people realized it would take many months, if not more than a year, to negotiate the new relationship between Britain and the many countries of Europe, and that it would be in no one's best interest to punish Britain in the form of trade barriers. But, business expenditures fell of the cliff. It looks like Britain's GDP will drop by 1% to 2%, and recent German Survey of Business Conditions reflect widespread pessimism. At the same time, Italian banks are dealing with non-performing loans which make up 18% of all loans. Of the 360-billion-euro non-performing debt, 200 billion are classified as bankrupt. There are similarly disappointing economic stories around the world. I receive continuous updates from Economist Harry Dent. The stock market will crash sooner or later.

FIXED RATE INTEREST INCOME!

I want to prove the merits of using fixed rate financial strategies verses stock market products; such as stocks, mutual funds, and ETFs. By the way, retirement income planning involves the study of account values (numbers). Never rely on past performance yields. Too often I hear advisors say, "You can buy a bond paying a 6% rate." What the advisor doesn't say matters. The price of a 6% bond in this market is greater than the repayment at the maturity date.

In this study, the investor purchased $500,000 of mutual funds in 2000. The mutual funds price appreciation matched the performance of the Dow Jones Industrial Average less a 1% annual fee – a performance only achieved by 20% of the investors in this country. We will compare the annual account values of the mutual funds with a fixed rate product paying 5% and fixed indexed annuities.

You will notice how the mutual funds lost money in 2000, 2001, 2002, 2008, 2011, and 2015. Of course, the 5% fixed rate stays the same. The fixed indexed annuity column illustrates the performance of my annuity accounts. Now, look at the numbers illustrating the values for 2015. The mutual funds earned less than 5%. My fixed indexed annuities beat the investments by 2:1!

Year-End	Investment Account	5% Annual Yield Account	Fixed Indexed Annuity
1997	649,800	525,000	698,060
1998	816,929	551,250	880,393
1999	968,305	578,813	953,730
2000	860,436	607,753	1,014,292
2001	739,631	638,141	1,071,599
2002	559,383	670,048	1,119,821
2003	701,354	703,550	1,364,838
2004	757,392	738,728	1,456,282
2005	772,540	775,664	1,536,378
2006	870,035	814,447	1,725,199
2007	892,047	855,170	1,854,589
2008	539,778	897,928	1,854,589
2009	662,415	942,825	1,919,499
2010	740,447	989,966	1,986,682
2011	733,043	1.039,464	2,056,216
2012	824,014	1,091,437	2,128,183
2013	1,067,922	1,146,009	2,202,670
2014	1,178,879	1,203,310	2,279,763
2015	1,155,301	1,263,475	2,359,555

You may remember the children's fable of the tortoise and the hare. The story teaches how the rabbit darted from one investment to another, but the turtle used a fixed interest rate account continuously making money year after year. Well, maybe the story wasn't exactly that way! But, the results are the same. The real saver reaps the benefits of accumulating money, compounding the interest earned year after year; rather than risking their money in the stock market!
Every financial planner says, "The stock market goes down, but over time the stock market trends upward." This is the "Hold and Hope Strategy." Investors cannot create a dependable retirement income because they repeatedly make and lose money over and over again. That's nuts!

The most successful retirement income strategy is the fixed rate product. It's more visible when money is withdrawn to supplement social security. The next table illustrates retirement income

withdrawals which are increased annually to offset inflation. The first year withdrawal was taken immediately and the remaining $475,000 used to open the illustrated accounts.

Year-End	Withdrawals	Investment Account	5% Fixed Rate	Fixed Indexed Annuity
1997	25,000	577,790	498,750	666,330
1998	25,575	635,544	496,834	808,120
1999	25,984	757,196	494,392	847,288
2000	26,556	678,180	491,228	872,849
2001	27,459	598,012	486,958	893,154
2002	28,228	468,591	481,666	903,848
2003	28,679	546,810	475,636	1,066,656
2004	29,339	528,597	468,612	1,106,817
2005	30,131	493,182	460,405	1,135,904
2006	31,155	532,671	450,713	1,240,522
2007	32,152	527,697	439,489	1,298,998
2008	33,053	322,310	426,758	1,265,945
2009	34,309	339,323	412,071	1,268,585
2010	34,309	335,576	396,650	1,271,304
2011	34,858	317,258	379,882	1,273,540
2012	35,973	301,819	361,104	1,274,694
2013	36,513	332,973	340,821	1,275,326
2014	37,093	315,112	318,914	1,275,380
2015	37,093	275,239	295,912	1,275,436

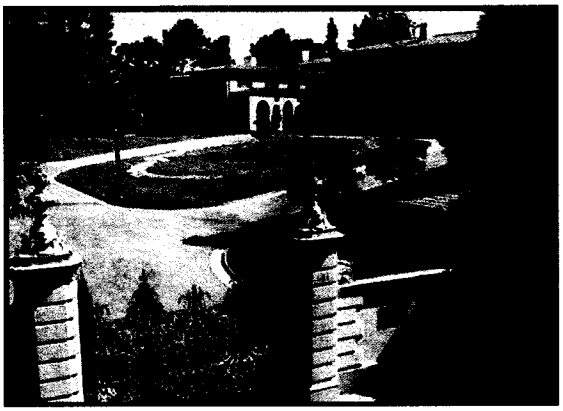
NEW STRATEGY EARNS A 5% TO 7% YIELD?

You can earn a 5% yield with a $100,000 minimum, 6% yield with a $500,000 minimum, or a 7% yield with a $1,000,000+ minimum using an account called, "First Position Commercial Mortgage (FPCM" Contract." It is a better solution for retirement income planning!

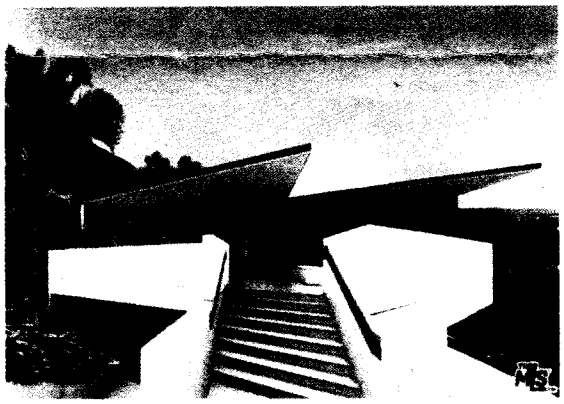
With a management team that has over 35 years of experience in offering financial opportunities, the company's hard-earned reputation for reliability and service is second to none. They provide a steady stream of income using a 1-year commercial bridge loan to property owners. Each bridge loan is secured by a valuable hard-asset – the property itself. Each property is debt-free and the owner is permitted to borrow up to 60% of its value. Your name is included on the lien filed with the local government. Plus, the company (rated A+ by the Better Business Bureau) issues a promissory note to guarantee the payment of the monthly interest checks and to return the money at the end of the term.

Since 2007, the company has originated tens of thousands of these commercial bridge loans, involving trillions of dollars. Every private lender has received their interest check and money returned on time. No one has ever lost any money! That's a better track record than my old employer, Chemical Bank of New York. I was a Regional Vice President when it failed.

The private lender can be an individual, couple or a trust. If the money is in a retirement account (such as a 401k, 403b, or IRA), the account is rolled over or transferred to a self-directed Traditional IRA account held by a trust company. The account can be a Roth IRA, SEP IRA, or an inherited IRA account. You pay no fees or commissions, and 100% of your money goes to work immediately. This is not a real estate investment trusts (REIT), annuity contract, or an investment regulated by the SEC. It is a commercial bridge loan!



In today's uncertain environment these contracts offer a safe, secured alternative to investments. As a private lender you will participate in commercial improvement projects – putting thousands of construction workers back to work. Here is an example of a recent 12- month project. The Owlwood Estate is located in Holmby Hills, California. The property was appraised at $90,000,000, and the owner qualified for a $54,000,000 loan (a 60% loan to value contract) to sub-divide the estate into multiple home sites. Within a few weeks this project was funded and work has already begun. If you had $100,000 in a money market account, your monthly interest check would have been about $70.83. Now, let's compare this interest check to a 5% yield FPCM account paying $416.67 a month.



There are a few properties requiring an 18-month term. These contracts are slightly different because they are likely to have a first mortgage. You will earn a 6% yield with a $200,000 minimum, and you can use multiple accounts (such as His IRA, Her IRA, and a Joint Account) where the combined amount satisfies the $200,000 minimum requirement. Again, you are paid monthly interest checks and the money returned or roll over at the end of the 18-month term.

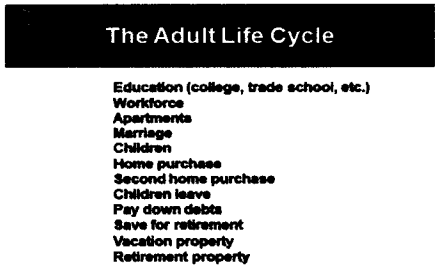
This 14,000 sq. ft. building was purchased for $13,500,000 using a $9,450,000 first mortgage for one year. To complete the project, the construction company needed $11,000,000. Once completed, this Los Angeles property has a appraised value of $55,000,000. Other private lenders have already pledged $10,300,000. If you placed $200,000 in this 18-month contract for a 6% yield, your monthly interest check will be $1,000/month for 18 months.

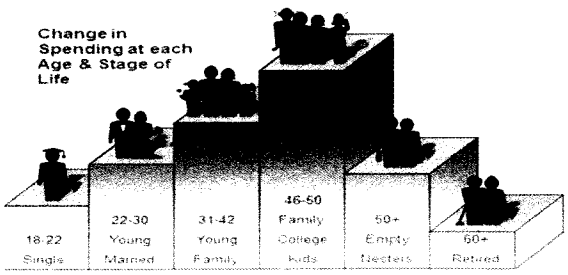
TWO WORLDWIDE STOCK MARKET CRASHES AHEAD (2016-2022)

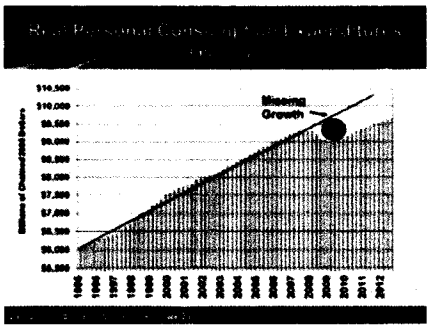
Tamara Christians, my daughter, and I are Lifetime Charter Members with a Master Certification of Economist Harry S. Dent Advisers Network – meaning we have completed a lengthy training program. Every year we recertify by attending his three-day "Irrational Economic Summit." This

year's summit has 17 nationally-recognized economists and industry experts presenting timely information about two forecasted stock market crashes ahead. Hundreds of investors attend in addition to Network Advisers like Tamara and me to study economic forecasting.

In 1993, Harry Dent introduced the demographic economic forecasting concept. Simply stated, the national economy is driven by consumption of goods and services. When the number of peak spenders (age 46-50) increase year after year, the economy trends upward. When the number of peak spenders decline year after year, the economy goes into a recession.







The Baby Boomer Generation passed age 50 in 2008, and the economy entered a recession. The missing growth in the consumption of goods and services will continue until 2022, as the Echo Boomer Generation become the nation's peak speakers.

Just imagine your parents spending money to support the Baby Boomers Generation's ever increasing needs. First, after the Second War World, the solders came home, got married, and began raising childred. The country saw a rapid increase in new home construction, new schools were built, new inter-state highways across the nation, the airline and airport system exploded, and the country experienced periods of inflation and the mutual funds industry grow from a mere 650 (when I became a financial planner) to tens of thousands today. All this economic growth came from our parents as the peak spenders of the time.

Now, the country doesn't need a new interstate highway system, new airports, new schools, and the real estate expansion is over! The world has entered the "Winter Economic Season." It's a 80-year cycle which has repeated for centuries. The last time we saw this cycle was just after the 1929 stock market crash and the depression of the 1930s. This cycle started in 2008.

The good news is it too will not last forever! The current economic decline was born out of the declining births (1962 through 1996). In 1997, the country renewed it's commitment towards larger families, and the number of babies born increased year after year. Dent termed this generation as "Echo Boomers." The United States is the only developed country to have Echo Boomers. Countries in Europe, Japan, and China (for example) still have decling birth rates. China and Europe will experience a depression beginning in 2016, lasting for decades.



There is another primary indictor of the economy. It is the Global Luxuary Brands Index Chart. This is the spending pattern of the more wealthy families. Since mid-2015 their spending has dropped 26%. These are the people who buy luxury items from companies like Nike, Este Lauder, Mercedes, Moet Vuitton, BMW, Carnival Cruises, and VF Corporation. Their reduced spending means lower profits and eventually lowers their stock prices. Nordstrom is down 36%. Ralph Lauren has crashed 46% since January 2016. Sotheby's is off 48% since June 2015. Tiffany & Co. is down 32% since August 2015. Williams-Sonboma is off 44% since October 2015. And, Louise Vuitton is down 24% since October 2015.

Clearly, the affluent sector is falling! Now, they benefited the most from Federal Reserve's zero interest rate policies and this artifical stock market bubble and "recovery," but it's now starting to break down. This is another monumental change in demographic trends and the final death knell for the economy. If the Federal Reserve thought it could fight the demographic decline and debt crisis since 2007 with endless quantitative easing (QE) and stimulus, Dent wants to see them fight this luxury peak spending downward trend. There's no way! Game over!!!

GET STARTED TODAY!

When you are ready to work with me, call 888-777-8685 to request your free personalized written retirement plan document. The process begins with a telephone interview. In Tampa you will meet with me in the privacy of their own home. Evening and weekend appointments are available. In the Grand Rapids, Michigan, area you will meet with Tamara Christians, my daughter, in her downtown office location!

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

Case No.: 9:18-cv-80019-DMM

PAUL HONIG, CARLA HONIG, DAVID LIPPMAN, CAROLYN LIPPMAN, JOHN HERTVIK, GERALD ROY, and HEMANT NANAVATY, on behalf of themselves and a class of all others similarly situated,

Plaintiffs,

vs.

BARRY M. KORNFELD, et al.,

Defendants,
_____/

SECOND AMENDED CLASS ACTION COMPLAINT AND DEMAND FOR JURY TRIAL

Plaintiffs, Paul Honig, Carla Honig, David Lippman, Carolyn Lippman, John Hertvik, Gerald Roy and Hemant Nanavaty on their own behalf and on behalf of all others similarly situated (collectively, "Plaintiffs"), sue Defendants Barry M. Kornfeld, Ferne E. Kornfeld, First Financial Tax Group, Inc., FEK Enterprises, Inc., Lynette M. Robbins, Theodore F. Leutz, Knowles Systems, Inc., Jordan E. Goodman, Albert D. Klager, Michelle Klager, Atlantic Insurance and Financial Services, Inc., Andrew G. Costa, David Anthony Cusano, James H. Gilchrist, Sr., Florida Tax Advisory Services, Inc., Gordon C. Hannah, Retirement Planning Solutions, LLC, Douglas R. Andrew, Paramount Financial Services, Inc., Robert S. Davis, Jr., Tony MacKenzie, Paula Burke, Old Security Financial Group Corp., James D. Helgeson, Kovak Securities, Inc., Jerry Davis Raines, HD Vest Investment Services, Inc., David Ouelette, Shield Financial Group, Inc., PanthRex Asset Management, LLC, Henry "Trae" Wieniewitz, Wieniewitz Wealth Management, LLC, and GBH CPAS, PC (individually and collectively, "Defendants") based upon the Plaintiffs'

Appendix 5

personal knowledge and investigations conducted through counsel, including a review of filings and publications of the Securities Exchange Commission ("SEC"), certain transcripts of SEC testimony, media reports, social media, and other analysis and information.

I. SUMMARY OF THE ACTION AND CLAIMS

1. Plaintiffs bring this action on behalf of a class of all those who purchased investments from Woodbridge Group of Companies, LLC d/b/a Woodbridge Wealth ("Woodbridge") or their affiliated entities. Woodbridge was in fact operated as a Ponzi scheme by Woodbridge's owner and operator, Robert H. Shapiro ("Shapiro").

2. Plaintiffs were marketed and sold promissory notes, fund equity units and other offerings as low-risk, high-yield investments backed by high interest rate loans made to commercial borrowers.

3. Plaintiffs and other Woodbridge investors were promised that they would be repaid from high interest rates that Shapiro's companies were earning on loans made to third-party borrowers. However, nearly all the purported third-party commercial borrowers were actually companies affiliated with Shapiro, which had no revenue, no bank accounts, and never paid any interest under the loans. Because Shapiro was not receiving any actual interest payments from purported borrowers, Shapiro used new investor funds to pay the interest and dividends owed to earlier investors, *i.e.*, the hallmark of a Ponzi scheme.

4. As of September 30, 2017, Woodbridge raised at least $114 million from approximately 700 investors residing in this District, and Woodbridge paid over $12 million in commissions to over 20 salespersons located in the Southern District of Florida.

5. Shapiro and the Woodbridge insiders knowingly engineered and executed the fraudulent promissory note scheme, but they did not act alone. Rather, Shapiro, through

Woodbridge, employed a network of hundreds of in-house and external sales agents who received substantial commissions in exchange for selling the Woodbridge securities to the public.

6. The external sales agent Defendants sold the Woodbridge investments to the public, and they knew or should have known that their uniform representations and scripted sales pitches to the Plaintiffs and other similarly situated investors that Woodbridge's promissory notes, fund equity units and other offerings were "low-risk, high-yield investments backed by high interest rate loans made to commercial borrowers" were false, inaccurate and misleading.

7. Defendant GBH CPAS, PC served as Woodbridge's accountant and ignored the glaring financial red flags reflecting that the Woodbridge enterprise was a fraud.

8. Each of the named Defendants agreed to join and participate in a civil conspiracy relating to the Woodbridge investments, and each Defendant committed overt acts in furtherance of the conspiracy that substantially aided and successfully "propped up" Woodbridge's fraudulent scheme. Indeed, but for the concerted participation and overt acts of each of the Defendants in furtherance of the conspiracy, the Woodbridge scheme would have either failed or unraveled at a much earlier point in time.

9. With the assistance of the Defendants, Woodbridge raised more than $1.22 billion from over 8,400 unsuspecting investors nationwide, many of whom reside in Florida and in the Southern District of Florida. By December 2017, however, the scheme collapsed, leaving investors with substantial losses estimated to be at least $961 million in principal alone.

10. The Plaintiffs and putative class member investors have been gravely injured as a consequence of the Defendants' conduct. This conduct includes the civil conspiracy of the sales agent Defendants, and each of the named co-conspirator Defendants is liable for the damages resulting from any and all other co-conspirator's actions.

11. There is a related action pending in the United States District Court for the Southern District of Florida styled *SEC v. Robert H. Shapiro, Woodbridge Group of Companies, LLC, et al.*, No. 17-24624 (S.D. Fla.) (the "SEC Action"). In its December 20, 2017 Complaint, the SEC alleges that the defendants in the SEC Action committed numerous violations of the federal securities laws.

II. THE PARTIES

A. Plaintiffs.

12. Plaintiff Paul Honig ("Mr. Honig") is a citizen of Palm Beach County, Florida. Mr. Honig invested in excess of $1,000,000 in Woodbridge promissory notes and fund equity units.

13. Plaintiff Carla Honig ("Mrs. Honig") is a citizen of Palm Beach County, Florida. Mrs. Honig invested in excess of $1,000,000 in Woodbridge promissory notes and fund equity units.

14. Plaintiff David Lippman ("Mr. Lippman") is a citizen of Palm Beach County, Florida. Mr. Lippman invested in excess of $100,000 in Woodbridge promissory notes.

15. Plaintiff Carolyn Lippman ("Mrs. Lippman") is a citizen of Palm Beach County, Florida. Mrs. Lippman invested in excess of $100,000 in Woodbridge promissory notes.

16. Plaintiff John Hertvik ("Mr. Hertvik") is a citizen of Palm Beach County, Florida. Mr. Hertvik invested in excess of $100,000 in Woodbridge promissory notes and fund equity units.

17. Plaintiff Gerald Roy ("Mr. Roy") is a citizen of Indian River County, Florida. Mr. Roy invested approximately $450,000 in Woodbridge promissory notes and fund equity units.

18. Plaintiff Hemant Nanavaty ("Mr. Nanavaty") is a citizen of Chicago, Illinois. Mr. Nanavaty invested in excess of $100,000 in Woodbridge promissory notes.

B. The Defendants.

(i) ***The Sales Agent Defendants***

19. Defendant Barry M. Kornfeld ("Barry Kornfeld") is citizen of Broward County, Florida. He holds himself out to be the Founder and principal of First Financial Tax Group, and conduct his investment advisory business principally in Boca Raton, Florida.

20. Defendant Ferne E. Kornfeld ("Ferne Kornfeld") is married to Defendant Barry Kornfeld, and she is a citizen of Broward County, Florida. She holds herself out to be the President of First Financial Tax Group and she is the President of FEK Enterprises, Inc. Fern Kornfeld conducts her investment advisory business principally in Boca Raton, Florida.

21. Defendant First Financial Tax Group Inc. ("First Financial") is a Florida corporation with its principal place of business and domicile in Boca Raton, Florida. First Financial is controlled by Barry Kornfeld and Ferne Kornfeld. At all material times, Barry and Ferne Kornfeld were employed by or affiliated with First Financial and acting within the course and scope of their actual or apparent agency with First Financial.

22. Defendant FEK Enterprises Inc. ("FEK Enterprises") is a Florida corporation with its principal place of business and domicile in Boca Raton, Florida, and it is the parent company of First Financial. FEK Enterprises is controlled by Barry Kornfeld and Ferne Kornfeld. At all material times, Barry and Ferne Kornfeld were employed by or affiliated with FEK Enterprises and acting within the course and scope of their actual or apparent agency with FEK Enterprises.

23. Defendant Lynette M. Robbins ("Robbins") is a citizen of Sumter County, Florida. She holds herself out as an officer and/or director of Knowles Systems, Inc.

24. Defendant Theodore F. Leutz ("Leutz") is married to Defendant Lynette M. Robbins, and he is a citizen of Sumter County, Florida. He holds himself out as an officer and/or

director of Knowles Systems, Inc.

25. Defendant Knowles Systems, Inc. ("Knowles Systems") is a Delaware corporation authorized to conduct business in Florida, and with its principal place of business and domicile in the Villages, Florida. Knowles Systems is controlled by Defendants Robbins and Leutz. At all material times, Robbins and Leutz were employed by or affiliated with Knowles Systems and acting within the course and scope of their actual or apparent agency with Knowles Systems.

26. Defendant Jordan E. Goodman ("Goodman") is a citizen of New York, New York.

27. Defendant Albert D. Klager ("Al Klager") is a citizen of Indian River County, Florida. He holds himself out as an officer and/or director of Atlantic Insurance and Financial Services, Inc.

28. Defendant Michele Klager ("Michelle Klager") is married to Defendant Al Klager, and a citizen of Indian River County, Florida. She holds herself out as an officer and/or director of Atlantic Insurance and Financial Services, Inc.

29. Defendant Atlantic Insurance and Financial Services, Inc. ("Atlantic") is a Florida corporation with its principal place of business and domicile in Vero Beach, Florida. Atlantic is controlled by Defendants Al and Michele Klager. At all material times, Al Klager and Michelle Klager were employed by or affiliated with Atlantic and acting within the course and scope of their actual or apparent agency with Atlantic.

30. Defendant Andrew G. Costa ("Costa") is a citizen of Palm Beach County, Florida.

31. Defendant David Anthony Cusano ("Cusano") is a citizen of Sarasota, Florida.

32. Defendant James H. Gilchrist, Sr. ("Gilchrist") is citizen of Ft. Pierce, Florida.

33. Defendant Florida Tax Advisory Services, Inc. ("Florida Tax") is a Florida corporation with its principal place of business and domicile in Stuart, Florida. Florida Tax is

controlled by Defendant Gilchrist. At all material times, Gilchrist was employed by or affiliated with Florida Tax and acting within the course and scope of his actual or apparent agency with Gilchrist.

34. Defendant Gordon C. Hannah ("Hannah") is citizen of Stuart, Florida.

35. Defendant Retirement Planning Solutions, LLC ("Retirement Solutions") is a Florida limited liability corporation with its principal place of business in Stuart, Florida. Retirement Solutions is controlled by Defendant Gordon C. Hannah. At all material times, Hannah was employed by or affiliated with Retirement Solutions and acting within the course and scope of their actual or apparent agency with Retirement Solutions.

36. Defendant Douglas R. Andrew ("Andrew") is a citizen of Salt Lake City, Utah. He holds himself out to be the Founder and principal of Paramount Financial Services, Inc.

37. Defendant Paramount Financial Services, Inc. ("Paramount") is a Utah corporation with its principal place of business and domicile in Salt Lake City, Utah. Paramount is controlled by Defendant Andrew, and Paramount and Andrew conduct business as Live Abundant and Live Abundant Financial. At all material times, Andrew was employed by or affiliated with Paramount and acting within the course and scope of his actual or apparent agency with Paramount.

38. Defendant Robert S. Davis, Jr. ("Davis") is a citizen of Houston, Texas. Davis holds himself as founder and officer of Old Security Financial Group Corp.

39. Defendant Tony MacKenzie ("MacKenzie") is a citizen of Houston, Texas. MacKenzie holds himself as founder and officer of Old Security Financial Group Corp.

40. Defendant Paula Burke ("Burke") is a citizen of Houston, Texas.

41. Defendant Old Security Financial Group Corp. ("Old Security") is a Texas for profit corporation with its principal place of business and domicile in Spring, Texas. At all material

times, Davis, MacKenzie and Burke were employed by or affiliated with Old Security and acting within the course and scope of their actual or apparent agency with Old Security.

42. Defendant James D. Helgeson ("Helgeson") is a citizen of Billings, Montana.

43. Defendant Kovak Securities, Inc. ("Kovac Securities") is a registered broker-dealer and member firm of the Financial Industry Regulatory Authority ("FINRA"), and which regularly conducts substantial business within the State of Florida. At all material times, Helgeson was employed by or affiliated with Kovac Securities as a registered representative of the firm, and was acting within the course and scope of his actual or apparent agency with Kovac Securities.

44. Defendant Jerry Davis Raines ("Raines") is a citizen of Kilgore, Texas.

45. Defendant HD Vest Investment Services, Inc. ("HD Vest") is a registered broker-dealer and member firm of the Financial Industry Regulatory Authority ("FINRA"), and which regularly conducts substantial business within the State of Florida. At all material times, Raines was employed by or affiliated with HD Vest as a registered representative of the firm, and was acting within the course and scope of his actual or apparent agency with HD Vest.

46. Defendant David Ouelette ("Ouelette") is a resident of San Antonio, Texas. Defendant Ouelette holds himself out as a founder and officer of Defendant Shield Financial Group, Inc.

47. Defendant Shield Financial Group, Inc. ("Shield Financial") is a Texas corporation with its principal place of business in San Antonio, Texas. At all material times, Ouelette was employed by or affiliated with Ouelette and acting within the course and scope of his actual or apparent agency with Ouelette.

48. Defendant PanthRex Asset Management, LLC ("PanthRex") is a Texas limited liability corporation with its principal place of business in Coppell, Texas, and a Registered

Investment Advisor with the Securities & Exchange Commission. At all material times, Ouelette was employed by or affiliated with PanthRex as an investment advisor of the firm, and was acting within the course and scope of his actual or apparent agency with PanthRex.

49. Defendant Henry "Trae" Wieniewitz ("Wieniewitz") is a resident of Knoxville, Tennessee.

50. Defendant Wieniewitz Wealth Management, LLC ("Wieniewitz Wealth") is a Tennessee limited liability corporation with its principal place of business in Knoxville, Tennessee, and a Registered Investment Advisor with the Securities & Exchange Commission. At all material times, Wieniewitz was employed by or affiliated with Wieniewitz Wealth as an investment advisor of the firm, and was acting within the course and scope of his actual or apparent agency with Wieniewitz Wealth.

51. The Defendants identified in Paragraph 19 through Paragraph 50 herein are collectively referenced herein as the "Sales Agent Defendants."

(ii) ***The Accountant Defendant***

52. Defendant GBH CPAS, PC ("GBH" or the "Accountant Defendant") is a Texas professional corporation with its principal place of business in Houston, Texas.

C. Relevant Non-Party Woodbridge Insiders.

53. Robert H. Shapiro ("Shapiro") is a Florida registered voter, and his voter information provides a Palm Beach County address. Until December 2017, Shapiro served as CEO of Woodbridge Group of Companies, LLC d/b/a Woodbridge Wealth ("Woodbridge") and trustee of the RS Trust. Woodbridge has served as the main operating company for Shapiro's business with approximately 140 employees in offices in six states, including in Boca Raton,

Florida. Woodbridge formerly operated as Woodbridge Structured Funding LLC and was headquartered in Boca Raton, Florida.

54. Dayne Roseman ("Roseman") is a resident of California, and was at all relevant times the Managing Director of Woodbridge. Roseman was charged by Woodbridge and Shapiro with the responsibility for supervising the sales agents and sales program of Woodbridge securities, including sales to investors in the Southern District of Florida.

55. Nina Pedersen ("Pedersen") is a resident of Volusia County, Florida, and was at all relevant times the Comptroller of Woodbridge.

56. RS Protection Trust ("RS Trust") is an irrevocable domestic asset protection trust settled under Nevada law under the control of Shapiro for the benefit of himself and his family. RS Trust is an umbrella asset trust holding all of Shapiro's business entities and personal assets, including, but not limited to Woodbridge. RS Trust, as the beneficial owner of all Shapiro's business entities, maintained operational control of each of the investment offerings to Plaintiffs through its ownership of Woodbridge

57. WMF Management, LLC ("WMF Management") is a California LLC controlled by Shapiro. WMF is a holding company for many of the companies comprising the Woodbridge Group Enterprise, all of which Shapiro controlled and operated, and which include Woodbridge Group of Companies, LLC, Woodbridge Mortgage Investment Fund 1, LLC, Woodbridge Mortgage Investment Fund 2, LLC, Woodbridge Mortgage Investment Fund 3, LLC, Woodbridge Mortgage Investment Fund 3A, LLC, Woodbridge Mortgage Investment Fund 4, LLC, Woodbridge Commercial Bridge Loan Fund 1, LLC, and Woodbridge Commercial Bridge Loan Fund 2, LLC (all of the foregoing referred to collectively as the "Woodbridge Investment Companies").

58. Woodbridge Structured Funding, LLC ("WSF") is a Delaware LLC formed on July 20, 2009 and controlled by Shapiro. From 2012 through approximately 2015, WSF served as the operating company of Shapiro's business entities, including but not limited to, the securities offerings at issue, and maintained Shapiro's businesses' primary bank account.

III. JURISDICTION AND VENUE

59. This court has original jurisdiction over the subject matter of this action under the Class Action Fairness Act, 28 U.S.C. § 1332(d). Plaintiffs are residents of Florida and throughout the United States, and Defendants reside in Florida and other states throughout the United States. The amount in controversy exceeds $5 million and there are over 100 members of the putative class.

60. This Court has personal jurisdiction over Defendants Barry Kornfeld, Ferne Kornfeld, First Financial, FEK Enterprises, Robbins, Leutz, Knowles Systems, Al Klager, Michelle Klager, Atlantic, Hannah, Retirement Planning, Costa, Cusano and Gilchrist because they are residents of the State of Florida and/or conduct regular and substantial business in the State. The Court has personal jurisdiction over each Defendant who is not a citizen of Florida ("Non-Resident Defendants") under Florida's long-arm statute because they have all conducted continuous and systematic business in the State of Florida by and through their co-conspirator Co-Defendants, and are therefore subject to the Court's general jurisdiction.

61. In addition, the Court has specific long-arm jurisdiction over each of the Non-Resident Defendants under Florida's long-arm statute because they all participated in and committed tortious acts directed toward Florida. As described in detail herein, all of the Sales Agent Defendants, by and through the tortious acts and omissions of their Florida resident co-conspirator Co-Defendants, have engaged in intentional, tortious conduct within the State of Florida, targeting the State of Florida and its citizens, and causing damages to the Plaintiffs within

the State of Florida, for the Defendants' own personal enrichment and benefit. Accordingly, personal jurisdiction over each of the Non-Resident Defendants is constitutionally and statutorily proper under Fla. Stat. §48.193(1)(a).

62. As further described herein, Defendant GBH caused injury and damages to the Plaintiffs within the State of Florida arising out of GBH's acts and omissions committed outside the State, and at the time of such injury and damages Defendant GBH was engaged in services activities on behalf of Woodbridge and Shapiro for products, materials and things used within the State of Florida in the ordinary course of commerce, trade, or use. Accordingly, personal jurisdiction over each of Defendant GBH is constitutionally and statutorily proper under Fla. Stat. §48.193(1)(a).

63. Venue is proper in this District pursuant to 28 U.S.C. § 1391 because the Defendants can be found or transact business in this District. Venue is also proper because Plaintiffs reside in this District and/or the acts and transactions alleged herein occurred in substantial part in this judicial district. Indeed, a substantial amount of Woodbridge investor funds were raised from Florida residents.

64. All conditions precedent to the filing of this action have occurred or have been waived.

IV. FACTUAL ALLEGATIONS COMMON TO ALL COUNTS

A. The Woodbridge Scheme.

65. Woodbridge raised more than $1.22 billion from over 8,400 investors nationwide. At least 2,600 of these investors used their individual retirement account funds to invest nearly $400 million.

66. Beginning in July 2012 through at least December 4, 2017, Shapiro orchestrated a Ponzi scheme using Woodbridge entities. Woodbridge was the principal operating company of Shapiro's businesses and employed approximately 140 people in offices in six states. Shapiro was the sole owner, and maintained exclusive operational control over Woodbridge and each of its entities.

67. Woodbridge sold investors two primary types of investments. The first was a twelve-to-eighteen-month term promissory note marketed as paying a 5%-8% annual return on a monthly basis known as First Position Commercial Mortgages ("FPCM"). The second was seven different private placement fund offerings with five-year terms ("Fund Offerings"), marketed as paying a 6%-10% annual return on a monthly basis and, at the end of five years, a 2% accrued dividend and share of the profits.

68. Neither of these two types of investments (collectively, "the Woodbridge investments") were ever registered with the SEC or another government agency.

69. The purported revenue source enabling Woodbridge to pay returns to investors was the interest a Woodbridge affiliate would be receiving on loans to third-party owners of commercial real estate. Woodbridge represented to investors that its affiliate would pool money from many investors and lend it to a third-party borrower for a short term, and for only about two-thirds of the value of the real estate securing the transaction, thereby ensuring that the "properties that secure the mortgages are worth considerably more than the loans themselves at closing."

70. Woodbridge told investors that these third-party borrowers were paying the company 11- 15% annual interest for "hard money," short-term financing. As an additional source of revenue, Woodbridge told investors that it would purchase properties to develop and sell for a profit.

71. In reality, Woodbridge's business model was a sham – the vast majority of the purported third-party borrowers were hundreds of Shapiro-owned and controlled LLCs, which had no source of income, no bank accounts, and never made any loan payments to Woodbridge, all facts Woodbridge and Shapiro concealed from investors. Rather, Shapiro and Woodbridge continued the ruse for the past several years by supporting their business operations nearly entirely by raising and using new investor funds, in classic Ponzi scheme fashion.

B. The Woodbridge Civil Conspiracy.

72. Because of the third-party borrowers' lack of revenue and lack of ability to make interest payments, Woodbridge and Shapiro required the continuous infusion of new funds from investors through the sale of additional unregistered securities to new investors to keep the scheme afloat.

73. Thus, the Woodbridge scheme depended on a sales team of approximately 30 in-house employees who operated within Woodbridge's offices and a network of several hundred external sales agents to solicit investments from the public.

74. External sales agents solicited the general public through television, radio, and newspaper advertising, cold calling, social media, websites, seminars, and in-person presentations.

75. Many of the sales agents were not licensed or registered with any regulatory agency, which was not disclosed to investors.

76. Woodbridge paid its external sales agents a 9% wholesale rate, and the sales agents in turn offered the FPCMs to their investor clients at 5% to 8% annual interest, and the external sales agent received the difference. Woodbridge paid its sales agents more than $64.5 million in commissions.

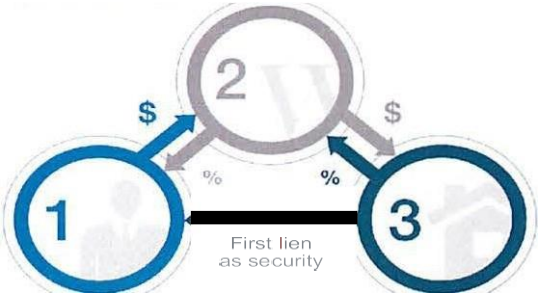
77. To generate the large volume of investor funds needed to sustain the scheme, Woodbridge aggressively promoted the FPCM notes by offering incentives, such as cash bonuses to brokers who recommended these investments to their clients. Woodbridge also established a program called "Pass It On," through which brokers were encouraged to inform their colleagues about the FPCM notes. Under that program, a referring broker would earn 25 basis points on each FPCM sale closed by a broker whom he or she referred.

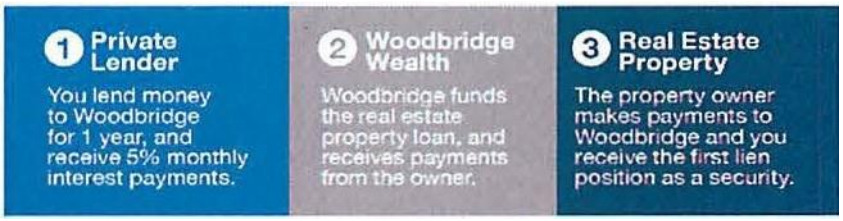
78. Woodbridge provided the sales agents with uniform, scripted information and sales materials which were in turn provided to investors (the "Woodbridge sales script"). All of the material information in the promotional materials was false.

79. Woodbridge and its sales force told investors that the third-party borrowers were paying it 11-15% in annual interest for "hard money" loans. The borrowers, Woodbridge told investors, were bona fide commercial property owners who could not obtain traditional loans and were willing to pay higher interest rates for short-term financing.

80. Woodbridge's marketing materials contained the following graphic regarding the FPCMs:

Now is the time to forego old-fashioned wealth-building solutions. Woodbridge Wealth wants to help you diversify your portfolio by participating in the real estate revolution. What does that look like?





Let us help you protect your retirement funds from market volatility. We succeed when you succeed. It's that simple.

81. In reality, the claimed interest payments from the purported third-party "property owner" (Circle 3) to Woodbridge (Circle 2) did not exist. Payments from the investors in the FPCMs and in the Fund Investments were instead derived almost exclusively from funds Woodbridge received from other investors.

82. Woodbridge and its sales force lied to investors when claiming that Woodbridge "receives the mortgage payments directly from the borrower, and Woodbridge in turn delivers the loan payments to you." Woodbridge's promotional FAQ document falsely claimed that "[y]our loan is secured by a hard asset collateral—the property itself."

83. Woodbridge falsely represented that after one year, the borrower would be obligated to repay Woodbridge the principal amount of the loan and that upon default Woodbridge could foreclose on the property to recover the full amount owed.

84. Woodbridge told FPCM investors that their returns would be derived from those interest payments, falsely promising the investors a pro rata first-position "lien" interest in the underlying properties: "If you have a first position, that means you have priority over any other liens or claims on a property if the property owner defaults." In the offering memoranda for the Fund Offerings, Woodbridge represented to investors that their funds would be used for real estate

acquisitions and investments, including in Woodbridge's own FPCMs. But in fact, Woodbridge directly applied the funds to pay other investors' returns.

85. Woodbridge's marketing materials state that it "receives the mortgage payments directly from the borrower, and Woodbridge in turn delivers the loan payments to you under your first position documents." That statement was false. Contrary to Woodbridge's representations, the great majority of the purported third-party borrowers were hundreds of Shapiro owned and controlled LLCs with no bank account or source of income, and which never made any loan payments to Woodbridge. Shapiro and his sales team concealed these facts from investors.

86. Woodbridge raised at least $1.22 billion from FPCM and Fund Offering investors but issued only approximately $675 million in "loans" for real estate purportedly securing the investments. Instead of generating the promised 11-15% interest, the loans generated only $13.7 million from third-party borrowers — far less than required to operate Woodbridge's business and pay investor returns.

C. The Role of the Woodbridge Insiders.

87. Shapiro orchestrated and operated the fraud through Woodbridge and its various affiliated entities.

88. Roseman was Woodbridge's Managing Director and Head of Sales, and he reported directly to Shapiro. Roseman directed internal and external sales agents to continue to raise funds from investors knowing that Woodbridge had no inventory of available real property and lacked revenue from development activity necessary to make interest payments to investors.

89. Roseman was responsible for ensuring that the sales force followed the Woodbridge "script," knowing that representations relating to the Woodbridge investments were false or

misleading. Shapiro directed Roseman to, and Roseman did in fact, withhold material information from investors.

90. Shapiro employed the RS Trust to conceal his fraudulent scheme and hide the fact that most of the third-party borrowers and owners of the underlying property were Shapiro and his family. Shapiro owns the real estate properties ultimately through RS Trust, whose trustee is Shapiro. None of the publicly available documentation indicated that RS Trust was the ultimate owner of the underlying properties that had been purchased with FPCM and Fund investors' funds. Investors were not told that the vast majority of loans were made to entities that had no revenue and that Shapiro controlled through RS Trust.

D. Defendants' Participation in the Woodbridge Civil Conspiracy.

91. Shapiro defrauded Woodbridge investors through the solicitation and sale of unregistered Woodbridge securities, but he did not act alone, and the scheme could not have been possible without the participation of others.

(i) *The Kornfeld Sales Agent Defendants.*

92. Barry Kornfeld and Ferne Kornfeld are husband and wife, are business partners, and were among the external sales people employed to perpetrate the Woodbridge scheme.

93. Both of the Kornfelds represent themselves to be the principals of Defendant First Financial Tax Group, headquartered in Boca Raton, Florida, with clients in Florida and throughout the United States. FEK Enterprises it is the parent company of First Financial. Defendants Barry Kornfeld, Ferne Kornfeld, First Financial and FEK Enterprises are collectively referred to herein as the "Kornfeld Sales Agent Defendants".

94. Barry Kornfeld holds himself out to be a financial advisor with an "unsurpassed level of expertise" and promises "trusting relationships with his clients" and "the best possible

results."[1] Barry Kornfeld claims a specialized focus on providing retirees and senior citizens with guaranteed income financial products to "ensure lives of prosperity and security in retirement" based on his purported understanding of "the complex psychology of aging and retirement planning."[2]

95. Barry Kornfeld actively promoted the Woodbridge FPCM investments. According to his blog, "A short term fixed-rate vehicle that Barry M. Kornfeld offers is first position commercial mortgages, which pay out 6% or higher, on an annual basis, with interest paid monthly."[3] Barry Kornfeld promotes himself as having "specialized knowledge of Co-Lending Opportunities. . . which are also known as first position commercial mortgage notes (FPCMs)." He promotes the FPCMs as safe and secure with a fixed high return.[4]

96. Barry Kornfeld has a checkered past, and he failed to disclose to any of his actual or potential clients – including the Plaintiffs – that he has been barred from the securities industry and from associating with any broker dealer or investment advisor as a result of regulatory actions taken by the SEC and the Financial Industry Regulatory Authority ("FINRA"). In fact, the SEC previously charged Barry Kornfeld with securities fraud for representing to retiree clients that collateralized mortgage obligations ("CMOS") were safe and secure investments.

97. Ferne Kornfield is a former registered securities broker who promotes herself as an experienced investment advisor specializing in providing investment advice and "guaranteed" returns to retirees as the President of First Financial Tax Group. According to Ferne Kornfeld:[5]

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[1] *See* https://www.linkedin.com/in/barrykornfeld (last visited 12/26/17).

[2] *Id.*

[3] *See* https://barykornfeld.wordpress.com (last visited 12/26/17).

[4] *See id.*

[5] *See* https://www.linkedin.com/in/ferne-kornfeld-13048159/ (last visited on 12/27/17).

> If you are looking for guaranteed income in retirement and estate planning solutions that work no matter which way the markets go, then we're a firm you'll want to talk to. I am a warm and caring financial professional specializing in holistic retirement planning for pre and post retirees. We integrate all aspects of life . . . guaranteed income, taxes, growth, inflation, estate planning, into a comprehensive & flulid plan to achieve a stress-free retirement. I have over 20 years' experience helping conservative investors seeking preservatrion of capital, guaranteed income and secure family planning strategies regardless of the ups & downs of the market or economic conditions. We are passionate about what we do & the people we help, and we are on a mission to make our clients' retirement everything they want it to be!

98. Barry Kornfeld and Ferne Kornfeld hold Ferne Kornfeld out to be an "instructor" of Baby Boomer Retirement Planning courses and Social Security Income Optimization Courses (the "Courses"). The Kornfelds used the Courses as a tool for targeting potential clients and soliciting attendees to invest in Woodbridge investments, pitching them as safe and secure.

99. Plaintiffs Paul and Carla Honig (among many others) were specifically targeted, solicited and induced to invest in Woodbridge investments by the Kornfelds after attending the Ferne Kornfeld Course.

100. Barry and Ferne Kornfeld utilized the false and misleading Woodbridge sales script to recommend and sell Woodbridge investments to Plaintiffs Paul and Carla Honig, David and Carolyn Lippman, and John Hertvik. Upon information and belief, the Kornfeld Defendants sold Woodbridge investments to hundreds of additional investors in Florida and throughout the United States.

101. Shapiro and Roseman characterized the Kornfelds as among the top producers of Woodbridge investor funds. According to Barry Kornfeld's sworn testimony to the SEC, the Kornfelds have at least 300 clients who invested over $50 million in Woodbridge investments.

(ii) ***The Klager Sales Agent Defendants.***

102. Defendants Albert D. Klager and Michelle Klager are a married couple. At all material times, Albert and Michelle Klager were affiliated with and conducted their investment

advisory business through, Defendant Atlantic Insurance and Financial Services, Inc. Defendants Al Klager, Michelle Klager and Atlantic are collectively referred to herein as the "Klager Sales Agent Defendants".

103. Al Klager and Michelle Klager utilized the false and misleading Woodbridge sales script to recommend and sell Woodbridge investments to Plaintiff Gerald Roy. Upon information and belief, the Klagers sold Woodbridge investments to hundreds of additional investors in Florida and throughout the United States.

104. On information and believe, Al and Michelle Klager raised approximately $20 million in principal through the sale of Woodbridge investments and were paid in excess of $1.2 million in commissions by Woodbridge. As such, Al and Michelle Klager's actions in providing a constant and significant source of investor funds were critical to the success of the Woodbridge scheme and conspiracy as it allowed Shapiro and Woodbridge to continue to defraud investors throughout the country.

(iii) ***The Knowles Systems Sales Agent Defendants.***

105. Defendants Lynette M. Robbins and Theodore F. Leutz are a married couple. At all material times, Robbins and Leutz were affiliated with and conducted their investment advisory business through, Defendant Knowles Systems.

106. Defendants Robbins, Leutz, and Knowles Systems are collectively referred to herein as the "Knowles System Sales Agent Defendants".

107. The Knowles System Sales Agent Defendants utilized the false and misleading Woodbridge sales script to recommend and sell Woodbridge investments to Plaintiff Hemant Nanavaty. Upon information and belief, the Knowles System Sales Agent Defendants utilized the

false and misleading Woodbridge sales script to recommend and sell Woodbridge investments to hundreds of investors in Florida, Chicago, Colorado and throughout the United States.

108. The Knowles System Sales Agent Defendants were substantially aided by Defendant Goodman. Goodman holds himself out as "America's Money Answers Man" and as a nationally-recognized expert on personal finance. Goodman entered into a finder and referral relationship with the Knowles System, Robbins and Leutz whereby Goodman pitched Woodbridge investments in exchange for a substantial share of the commissions generated from sale of Woodbridge investments from the investors he referred.

109. Goodman utilized the false and misleading Woodbridge sales script to recommend Woodbridge investments during his regular guest appearances on numerous financial radio call-in shows across the country, and then referred potential investors who responded to his solicitation to Knowles Systems, Robbins and Leutz. Goodman also participated in a pod-cast posted on Knowles Systems' website in which he interviewed Robbins and recommended the Woodbridge investments pitched by the Knowles System Defendants.

110. Plaintiff Nanavaty learned about the Woodbridge investments while listening to one of Goodman's radio appearances. Nanavaty thereafter contacted Goodman and communicated with him via telephone and email, during which Goodman represented that the Woodbridge investments were "safe and secure" and referred Nanavaty to the Knowles Systems, Robbins and Leutz for the purposes of purchasing unregistered Woodbridge securities.

111. On information and believe, the Knowles System, Robbins and Leutz, with the assistance of Goodman, raised approximately $147 million in principal through the sale of Woodbridge investments and were paid in excess of $8 million in commissions by Woodbridge. As such, the Knowles System, Robbins and Leutz were the top producers of Woodbridge investor

funds, and their actions in providing a constant and significant source of investor funds were critical to the success of the Woodbridge scheme and conspiracy as it allowed Shapiro and Woodbridge to continue to defraud investors throughout the country.

(iv) ***The Remaining External Sales Agent Defendants.***

112. Defendants Costa, Cusano, Gilchrist, Hannah, Retirement Solutions, Andrew, Paramount, Davis, MacKenzie, Burke, Old Security, Helgeson, Kovak Securities, Raines, HD Vest, Ouelette, Shield Financial, PanthRex, Wieniewitz, Wieniewitz Wealth, and Harris similarly utilized the false and misleading Woodbridge sales script and participated in the purchase and sale of unregistered Woodbridge securities to thousands of additional investors in Florida and throughout the United States. These Defendants' actions were critical and essential to the success of the Woodbridge scheme and civil conspiracy.

(v) ***The Accountant Defendant.***

113. Defendant GBH CPAS is an accounting firm specializing in providing audit services for public companies and closely-held private companies. GBH CPAS performed accounting services for Woodbridge and its affiliated Woodbridge entities during the time Woodbridge was operating as a Ponzi scheme.

114. In order to perform its accounting functions, GBH CPAS, including through its Senior Audit Manager Cory Ellspermann, communicated directly and regularly with Shapiro and Pedersen in her Florida office for information about the Woodbridge entities' business activities and financial books, records, and bank accounts. For example, in a series of 2015 emails, Mr. Ellspermann requested information related to the financial and banking records for Woodbridge mortgage investments funds, the Woodbridge Investment Companies, and Woodbridge Structured Funding, and he received responses from Pedersen.

115. GBH CPAS was retained to perform compilation services with respect to Woodbridge's financial statements. GBH CPAS had a duty to determine whether Woodbridge's financial statements appeared to be free from misstatements, fraud or error. Upon discovering any such misstatements, fraud or error, GBH CPAS was required to propose corrective revisions to the financial statements. In fulfilling this duty, GBH CPAS was required to obtain a thorough understanding of Woodbridge's accounting policies and financial reporting framework. GBH CPAS was required to ensure that evidence of Woodbridge's financial condition was obtained from reliable sources.

116. GBH CPAS failed to fulfill these duties and thereby assisted Shapiro and Woodbridge in perpetrating the Ponzi scheme and defrauding investors.

117. GBH CPAS accepted questionable financial information from Pedersen, who was an unreliable source of information given her patent lack of accounting experience or expertise.

118. GBH CPAS failed to address or simply ignored numerous glaring financial red flags at Woodbridge:

a. That the Woodbridge enterprise did not generate sufficient profits to pay promised returns to investors.

b. That the Woodbridge business activities were not consistent with Woodbridge's stated business model.

c. That the Woodbridge entities' accounting records did not reflect the correct amount of income and assets that is consistent with the cash flow activity reflected in Woodbridge entities' bank records.

d. That the Woodbridge entities made improper payments of at least $21.2 million to or for the benefit of Shapiro, his relatives or related entities.

e. That the Woodbridge operating entities' intercompany QuickBooks accounts did not reconcile with the Woodbridge fund entities' intercompany accounts.

f. That the Woodbridge fund entities' QuickBooks reflect mortgages receivable and some owned real estate assets. The manner in which the Woodbridge fund entities recorded these assets primarily comprised of journal entries as a "due to" in an intercompany account. There was no transfer of cash from the Woodbridge fund entities in such transactions, effectively creating assets with only book entries and not represented by a cash transaction.

g. That a significant amount of the interest income revenue recorded in the Woodbridge fund entities' QuickBooks was not cash collected from third parties but instead was recorded as an intercompany receivable transaction with the Woodbridge operating entities. Although an intercompany receivable transaction was recorded in the Woodbridge fund entities' QuickBooks, in many instances, no corresponding cash receipt was identified in the Woodbridge operating entities' bank account nor was a corresponding journal entry reflecting the intercompany transaction recorded in the Woodbridge fund entities' QuickBooks.

h. That the Woodbridge fund entities recorded assets duplicative of the Woodbridge operating entities**.**

119. Moreover, the Woodbridge fund entities' books and records did not include the customary accounting and banking transactional flow that one would expect to see in the bank accounts and Woodbridge fund entities' QuickBooks. This includes transaction flows relating to the receipt and use of investor funds. As a result, the Woodbridge entities' accounting records do not reflect the correct amount in income and assets that is consistent with the cash flow activity reflected in the Woodbridge Entities' bank records, resulting in an artificial representation of the income generated and assets available to pay Woodbridge investors.

120. Had GBH CPAs undertaken the proper analysis of the Woodbridge financials, it would have determined that the Woodbridge was not legitimately a going concern and could not have functioned as a legitimate or profitable enterprise. Instead, GBH CPAS failed to adhere to applicable accounting standards, which permitted Woodbridge to misstate its financial condition and perpetuate its fraudulent scheme.

E. The Woodbridge Ponzi Scheme Unravels.

121. At least five states, including Texas, Massachusetts, Arizona, Pennsylvania, and Michigan, previously issued cease and desist orders against one or more of the Woodbridge entities based on their unregistered sale of securities. The Sales Agent Defendants nonetheless continued to sell Woodbridge's unregistered securities in exchange for illicit commissions.

122. On December 1, 2017, still owing more than $961 million in principal to investors, Woodbridge and Shapiro missed their first interest payments to investors. On December 4, 2017, Shapiro caused most of his companies to declare Chapter 11 bankruptcy (none of which are named Defendants here).

123. There are no material differences between the actions committed by the Defendants against the Plaintiffs and committed against the other Class members.

V. CLASS ACTION ALLEGATIONS

124. Plaintiffs bring this action as a class action pursuant to Federal Rules of Civil Procedure 23. The definition of the Plaintiff class and subclasses are as follows:

a. All persons who invested in the Woodbridge FPCMs and Funds, excluding Defendants, their affiliates, subsidiaries, agents, officers, directors and/or employees.

b. All persons who invested in Woodbridge FPCMs and Funds who reside in the State of Florida, excluding Defendants, their affiliates, subsidiaries, agents, officers, directors and/or employees.

c. All persons who invested in Woodbridge FPCMs and Funds based on the solicitation or participation of the Knowles System Sales Agent Defendants and/or Defendant Goodman, excluding the Knowles System Sales Agent Defendants and Defendant Goodman, their affiliates, subsidiaries, agents, officers, directors and/or employees.

d. All persons who invested in Woodbridge FPCMs and Funds based on the solicitation or participation of the Sales Agent Defendants, excluding the Sales Agent Defendants, their affiliates, subsidiaries, agents, officers, directors and/or employees.

125. Plaintiffs reserve the right to modify or amend the proposed class definitions prior to the time the Court determines whether a class certification is proper.

126. Defendants subjected the Plaintiffs and the respective Class members to the same unfair, unlawful, and deceptive practices and harmed them in the same matter.

127. The Class meets the requirements for class certification under Rule 23(a) of the Federal Rules of Civil Procedure.

a. **Numerosity**. The members of the Class are so numerous that joinder of all members is impracticable. Defendants' conduct as alleged in this Complaint harmed hundreds of investors in Florida and thousands nationwide. Individual Class members are ascertainable as they may be identified from records maintained by Defendants, and the precise number of the Class can be determined through discovery; however, the number of Class members are clearly more than

can be consolidated in one complaint such that it would be impractical for each Class member to bring suit individually. The members of the Class may be notified of the pendency of this action by mail or otherwise using a form of notice similar to that customarily used in class actions.

b. **Commonality**. Common questions of law and fact exist as to all members of the Class and predominate over any questions affecting solely individual members of the Class. Among the questions of law and fact common to the Class are:

i. whether the Sales Agent Defendants breached their duty of care and/or breached their fiduciary duties to the Plaintiffs in soliciting and selling Plaintiffs Woodbridge investments;

ii. whether and to what extent Plaintiffs were damaged by the wrongful conduct of Defendants;

iii. whether Defendant GBH CPAS was negligent and failed to exercise due professional care;

iv. whether and to what extent Plaintiffs were damaged by the negligence of GBH CPAS;

v. whether the Woodbridge investments were securities as defined by state or federal law that had to be registered under the applicable federal or state securities laws and regulations;

vi. whether the Defendants were engaged in the sale of unregistered securities to Plaintiffs or otherwise participated in the sale of unregistered securities under Chapter 517, Florida Statues and other applicable State Blue Sky Laws;

vii. whether Plaintiffs are entitled to rescission and/or damages, and in what amounts, under Chapter 517, Florida Statues and other applicable State Blue Sky Laws;

viii. whether the Sales Agent Defendants joined and participated in a civil conspiracy to commit unlawful acts or to use unlawful means;

ix. whether the Sales Agent Defendants engaged in one or more overt acts in furtherance of a civil conspiracy; and

x. whether and to what extent Plaintiffs were damaged by the Sales Agent Defendants' civil conspiracy.

c. **Typicality.** Plaintiffs' claims are typical of the claims of members of the Class as all members of the Class were similarly affected by the Defendants' wrongful conduct in violation of law as alleged herein. The named Plaintiffs are members of the Class and the losses to the named Plaintiffs are based on the same legal theories.

d. **Adequacy**. Plaintiffs will fairly and adequately represent and protect the interest of the members of the Class, and they are committed to vigorously prosecuting these claims. Plaintiffs have retained competent and experienced counsel in litigation of this nature. There is no hostility between Plaintiffs and unnamed Class members. Plaintiffs do not anticipate any difficulty in the management of this litigation as a class action.

128. This class action also meets the requirements of Federal Rule of Civil Procedure 23(b)(3). The common issues outlined herein predominate over any individual issues in the case. A class action is superior to an individual action and to all other available methods of the fair and efficient adjudication of this controversy since joinder of all members is impracticable.

129. The class members did not discover, and could not with the exercise of reasonable diligence have discovered, the true nature of their losses until the SEC filed its Complaint in the SEC Action on December 20, 2017. The wrongful acts by Defendants were inherently undiscoverable, and Plaintiffs were not aware of facts that would have put them on inquiry notice with respect to Defendants' role in the Woodbridge scheme until now.

COUNT I
Negligence
(Plaintiffs Honig, Lippman and Hertvik against the Kornfeld Sales Agent Defendants)

130. Plaintiffs re-allege Paragraphs 1 through 129, and incorporate the same as if fully set forth herein.

131. The Kornfeld Sales Agent Defendants owed Plaintiffs Paul and Carla Honig, David and Carolyn Lippman and John Hertvik a duty of due care as investment advisors. This duty included the obligation to perform reasonable due diligence on these Plaintiffs' behalf prior to selling them Woodbridge FPCMs and Fund Offerings.

132. The Kornfeld Sales Agent Defendants breached their duty of care and were negligent in selling the Woodbridge FPCMs, Fund Offerings and other Woodbridge investments. The Kornfeld Sales Agent Defendants knew or should have known that Woodbridge investments were fraudulent and/or unregistered in violation of state and federal securities laws. The Kornfeld Sales Agent Defendants failed to perform any due diligence of Woodbridge, the FPCMs, or the Fund Offerings. The Kornfeld Sales Agent Defendants also ignored numerous red flags concerning the Woodbridge FPCMs and Fund Offerings, including, among other things, that:

a. The FPCMs and Fund Offerings were unregistered securities, but the Kornfeld Sales Agent Defendants did not make (and were not required by Woodbridge to make) any effort to determine whether an investor was accredited or sophisticated;

b. The Fund Offerings claimed that Woodbridge was paying commissions to "licensed broker/dealers," but the Kornfeld Sales Agent Defendants were not registered with any regulatory agency yet received commissions from Woodbridge;

c. The sales packets supplied by Woodbridge to the Kornfeld Sales Agent Defendants for distribution to investors listed examples of real property being used for the FPCMs and Fund Offerings, but those properties were not owned by actual third-party borrowers;

d. Woodbridge threatened to terminate external sales agents like the Kornfeld Sales Agent Defendants who would not permit Woodbridge to contact investors directly about rolling over short-term FPCMs into longer term Fund Offerings;

e. Despite Woodbridge's purported multi-million dollar nationwide real estate investment and development operations, all Woodbridge checks to investors and sales agents were hand-signed by Shapiro.

133. The Kornfeld Sales Agent Defendants' breach of their duty of care directly and proximately caused Plaintiffs Paul and Carla Honig, David and Carolyn Lippman and John Hertvik to sustain significant damages.

COUNT II
Negligence
(Plaintiff Roy against the Klager Sales Agent Defendants)

134. Plaintiffs re-allege Paragraphs 1 through 129, and incorporate the same as if fully set forth herein.

135. The Klager Sales Agent Defendants owed Plaintiff Gerald Roy a duty of due care as investment advisors. This duty included the obligation to perform reasonable due diligence on Roy's behalf prior to selling him Woodbridge FPCMs and Fund Offerings.

136. The Klager Sales Agent Defendants breached their duty of care and were negligent in selling the Woodbridge FPCMs, Fund Offerings and other Woodbridge investments. The

Klager Sales Agent Defendants knew or should have known that Woodbridge investments were fraudulent and/or unregistered in violation of state and federal securities laws. The Klager Sales Agent Defendants failed to perform any due diligence of Woodbridge, the FPCMs, or the Fund Offerings. The Klager Sales Agent Defendants also ignored numerous red flags concerning the Woodbridge FPCMs and Fund Offerings, including, among other things, that:

a. The FPCMs and Fund Offerings were unregistered securities, but the Klager Sales Agent Defendants did not make (and were not required by Woodbridge to make) any effort to determine whether an investor was accredited or sophisticated;

b. The Fund Offerings claimed that Woodbridge was paying commissions to "licensed broker/dealers," but the Klager Sales Agent Defendants were not registered with any regulatory agency yet received commissions from Woodbridge;

c. The sales packets supplied by Woodbridge to the Klager Sales Agent Defendants for distribution to investors listed examples of real property being used for the FPCMs and Fund Offerings, but those properties were not owned by actual third-party borrowers;

d. Woodbridge threatened to terminate external sales agents like the Klager Sales Agent Defendants who would not permit Woodbridge to contact investors directly about rolling over short-term FPCMs into longer term Fund Offerings;

e. Despite Woodbridge's purported multi-million dollar nationwide real estate investment and development operations, all Woodbridge checks to investors and sales agents were hand-signed by Shapiro.

137. The Klager Sales Agent Defendants' breach of their duty of care directly and proximately caused Plaintiff Gerald Roy to sustain significant damages.

COUNT III
Negligence
(Plaintiff Nanavaty against the Knowles System Agent Defendants)

138. Plaintiffs re-allege Paragraphs 1 through 129, and incorporate the same as if fully set forth herein.

139. The Knowles System Sales Agent Defendants owed Plaintiff Hemant Nanavaty a duty of due care as investment advisors. This duty included the obligation to perform reasonable due diligence on Nanavaty's behalf prior to selling him Woodbridge FPCMs and Fund Offerings.

140. The Knowles System Sales Agent Defendants breached their duty of care and were negligent in selling the Woodbridge FPCMs, Fund Offerings and other Woodbridge investments. The Knowles System Sales Agent Defendants knew or should have known that Woodbridge investments were fraudulent and/or unregistered in violation of state and federal securities laws. The Knowles System Sales Agent Defendants failed to perform any due diligence of Woodbridge, the FPCMs, or the Fund Offerings. The Knowles System Sales Agent Defendants also ignored numerous red flags concerning the Woodbridge FPCMs and Fund Offerings, including, among other things, that:

a. The FPCMs and Fund Offerings were unregistered securities, but the Knowles System Sales Agent Defendants did not make (and were not required by Woodbridge to make) any effort to determine whether an investor was accredited or sophisticated;

b. The Fund Offerings claimed that Woodbridge was paying commissions to "licensed broker/dealers," but the Knowles System Sales Agent Defendants were not registered with any regulatory agency yet received commissions from Woodbridge;

c. The sales packets supplied by Woodbridge to the Knowles System Sales Agent Defendants for distribution to investors listed examples of real property being used for the FPCMs and Fund Offerings, but those properties were not owned by actual third-party borrowers;

d. Woodbridge threatened to terminate external sales agents like the Knowles System Sales Agent Defendants who would not permit Woodbridge to contact investors directly about rolling over short-term FPCMs into longer term Fund Offerings;

e. Despite Woodbridge's purported multi-million dollar nationwide real estate investment and development operations, all Woodbridge checks to investors and sales agents were hand-signed by Shapiro.

141. The Knowles System Sales Agent Defendants' breach of their duty of care directly and proximately caused Plaintiff Hemant Nanavaty to sustain significant damages.

COUNT IV
Negligence
(Plaintiff Nanavaty against Defendant Goodman)

142. Plaintiffs re-allege Paragraphs 1 through 129, and incorporate the same as if fully set forth herein.

143. Defendant Goodman held himself out to Plaintiff Hemant Nanavaty as investment advisors and as such owed a duty of due care to Nanavaty. This duty included the obligation to perform reasonable due diligence on Nanavaty's behalf prior to recommending and soliciting him to purchase Woodbridge FPCMs and Fund Offerings.

144. Defendant Goodman breached his duty of care and were negligent in recommending and participating in the sale of the Woodbridge FPCMs, Fund Offerings and other Woodbridge investments. Defendant Goodman knew or should have known that Woodbridge investments were fraudulent and/or unregistered in violation of state and federal securities laws. Defendant Goodman failed to perform any due diligence of Woodbridge, the FPCMs, or the Fund Offerings. Defendant Goodman also ignored numerous red flags concerning the Woodbridge FPCMs and Fund Offerings, including, among other things, that:

a. The FPCMs and Fund Offerings were unregistered securities, but Defendant Goodman did not make (and were not required by Woodbridge to make) any effort to determine whether an investor was accredited or sophisticated;

b. The Fund Offerings claimed that Woodbridge was paying commissions to "licensed broker/dealers," but Defendant Goodman was not registered with any regulatory agency yet received commissions from Woodbridge;

c. The sales packets supplied by Woodbridge for distribution to investors listed examples of real property being used for the FPCMs and Fund Offerings, but those properties were not owned by actual third-party borrowers;

d. Woodbridge threatened to terminate external sales agents who would not permit Woodbridge to contact investors directly about rolling over short-term FPCMs into longer term Fund Offerings;

e. Despite Woodbridge's purported multi-million dollar nationwide real estate investment and development operations, all Woodbridge checks to investors and sales agents were hand-signed by Shapiro.

145. Defendant Goodman's breach of his duty of care directly and proximately caused Plaintiff Hemant Nanavaty to sustain significant damages.

COUNT V
Breach of Fiduciary Duty
(Plaintiffs Honig, Lippman and Hertvik against the Kornfeld Sales Agent Defendants)

146. Plaintiffs re-allege Paragraphs 1 through 129, and incorporate the same as if fully set forth herein.

147. The Kornfeld Sales Agent Defendants held themselves out as experienced investment advisors. The Kornfeld Sales Agent Defendants purported to advise and instruct Plaintiffs Paul and Carla Honig, David and Carolyn Lippman and John Hertvik on the suitability

of the Woodbridge FPCMs and Fund Offerings for their investment needs. These Plaintiffs reposed their trust and confidence in the Kornfeld Sales Agent Defendants, which they accepted. As such, the Kornfeld Sales Agent Defendants owed Plaintiffs Paul and Carla Honig, David and Carolyn Lippman and John Hertvik a fiduciary duty to act fairly and honestly, in good faith, and to make full and fair disclosure of material facts.

148. The Kornfeld Sales Agent Defendants abused and violated their fiduciary duties to Plaintiffs Paul and Carla Honig, David and Carolyn Lippman and John Hertvik by failing to do sufficient due diligence on the Woodbridge FPCMs and Fund Offerings (if they ever did any at all) prior to selling the FPCMs and Fund Offerings to these Plaintiffs.

149. The Kornfeld Sales Agent Defendants abused and violated their fiduciary duties to Plaintiffs Paul and Carla Honig, David and Carolyn Lippman and John Hertvik by failing to disclose that the Woodbridge FPCMs and Fund Offerings were unregistered securities, that the Kornfeld Sales Agent Defendants were not registered with the SEC or any other regulatory agency, and that Barry Kornfeld had been barred by the SEC from associating with any broker, dealer, or investment adviser.

150. The Kornfeld Sales Agent Defendants' breaches of fiduciary duty directly and proximately caused the Plaintiffs Paul and Carla Honig, David and Carolyn Lippman and John Hertvik to sustain significant damages.

COUNT VI
Breach of Fiduciary Duty
(Plaintiff Roy against the Klager Sales Agent Defendants)

151. Plaintiffs re-allege Paragraphs 1 through 129, and incorporate the same as if fully set forth herein.

152. The Klager Sales Agent Defendants held themselves out as experienced investment advisors. The Klager Sales Agent Defendants purported to advise and instruct Plaintiff Gerald Roy on the suitability of the Woodbridge FPCMs and Fund Offerings for their investment needs. Plaintiff Roy reposed his trust and confidence in the Klager Sales Agent Defendants, which they accepted. As such, the Klager Sales Agent Defendants owed Plaintiff Roy a fiduciary duty to act fairly and honestly, in good faith, and to make full and fair disclosure of material facts.

153. The Klager Sales Agent Defendants abused and violated their fiduciary duties to Plaintiff Roy by failing to do sufficient due diligence on the Woodbridge FPCMs and Fund Offerings (if they ever did any at all) prior to selling the FPCMs and Fund Offerings to Roy.

154. The Klager Sales Agent Defendants abused and violated their fiduciary duties to Plaintiff Roy by failing to disclose that the Woodbridge FPCMs and Fund Offerings were unregistered securities, and that the Klager Sales Agent Defendants were not registered with the SEC or any other regulatory agency.

155. The Klager Sales Agent Defendants' breaches of fiduciary duty directly and proximately caused the Plaintiff Roy to sustain significant damages.

COUNT VII
Breach of Fiduciary Duty
(Plaintiff Nanavaty against the Knowles System Sales Agent Defendants)

156. Plaintiffs re-allege Paragraphs 1 through 129, and incorporate the same as if fully set forth herein.

157. The Knowles System Sales Agent Defendants held themselves out as experienced investment advisors. The Knowles System Sales Agent Defendants purported to advise and instruct Plaintiff Hemant Nanavaty on the suitability of the Woodbridge FPCMs and Fund Offerings for their investment needs. Plaintiff Nanavaty reposed his trust and confidence in the

Knowles System Sales Agent Defendants, which they accepted. As such, the Knowles System Sales Agent Defendants owed Plaintiff Nanavaty a fiduciary duty to act fairly and honestly, in good faith, and to make full and fair disclosure of material facts.

158. The Knowles System Sales Agent Defendants abused and violated their fiduciary duties to Plaintiff Nanavaty by failing to do sufficient due diligence on the Woodbridge FPCMs and Fund Offerings (if they ever did any at all) prior to selling the FPCMs and Fund Offerings to Nanavaty.

159. The Knowles System Sales Agent Defendants abused and violated their fiduciary duties to Plaintiff Nanavaty by failing to disclose that the Woodbridge FPCMs and Fund Offerings were unregistered securities and that the Knowles System Sales Agent Defendants were not registered with the SEC or any other regulatory agency.

160. The Knowles System Sales Agent Defendants' breaches of fiduciary duty directly and proximately caused the Plaintiff Nanavaty to sustain significant damages.

COUNT VIII
Breach of Fiduciary Duty
(Plaintiff Nanavaty against Defendant Goodman)

161. Plaintiffs re-allege Paragraphs 1 through 129, and incorporate the same as if fully set forth herein.

162. Defendant Goodman held himself out to Plaintiff Nanavaty as "America's Money Answers Man" and as a nationally-recognized expert on personal finance. Goodman advised and instructed Plaintiff Nanavaty on the suitability of the Woodbridge FPCMs and Fund Offerings for his investment needs. Plaintiff Nanavaty reposed his trust and confidence in Goodman, which he accepted. As such, Defendant Goodman owed Plaintiff Nanavaty a fiduciary duty to act fairly and honestly, in good faith, and to make full and fair disclosure of material facts.

163. Defendant Goodman abused and violated his fiduciary duties to Plaintiff Nanavaty by failing to do sufficient due diligence on the Woodbridge FPCMs and Fund Offerings (if they ever did any at all) prior to recommending and participating in the sale of the FPCMs and Fund Offerings to Nanavaty.

164. Defendant Goodman abused and violated his fiduciary duties to Plaintiff Nanavaty by failing to disclose that the Woodbridge FPCMs and Fund Offerings were unregistered securities, and that neither Goodman nor the Knowles System Sales Agent Defendants were not registered with the SEC or any other regulatory agency.

165. Defendant Goodman's breaches of fiduciary duty directly and proximately caused the Plaintiff Nanavaty to sustain significant damages.

COUNT IX
Sale of Unregistered Securities in Violation of Chapter 517, Florida Statutes
(Plaintiffs Honig, Lippman and Hertvik against the Kornfeld Sales Agent Defendants)

166. Plaintiffs re-allege the allegations set forth in Paragraph 1 through 129, as if fully set forth herein.

167. This is a claim by Plaintiffs Paul and Carla Honig, David and Carolyn Lippman and John Hertvik against the Kornfeld Sales Agent Defendants for violations of Chapter 517 of the Florida Act arising from the sale of unregistered securities in the state of Florida.

168. The Kornfeld Sales Agent Defendants' offers of FPCMs and Fund investments violated section 517.211, Florida Statutes, which provides a private right of action for violations of section 517.07, Florida Statutes.

169. Section 517.07 provides that "[i]t is unlawful and a violation of this chapter for any person to sell or offer to sell a security within this state" unless the security or transaction is "exempt" under Chapter 517, or unless the security is "registered pursuant to this chapter."

170. The FPCMs and Fund investments are securities as defined in section 517.021(21), Florida Statutes.

171. Despite attempts to evade compliance with registration requirements by claiming a Regulation D exemption, the nation-wide offering of FPCMs and Fund investments to purportedly "accredited" U.S. investors was in fact an unregistered public offering made in violation of state and federal securities laws. It was an integrated offering under the securities laws, and, on information and belief, involved each of the following factors that made it a public offering and not a private offering exempt from registration:

a. The integrated offering involved general solicitation. This general solicitation by Woodbridge affiliates, agents and brokers, included general public advertisements, publicly distributed magazine articles, television and other communications and media published in print throughout the country, including in Florida, and distributed broadly for general distribution in the United States, including in Florida.

b. The integrated offering involved general solicitation through television advertisement, internet advertisement, seminars and meetings conducted in the United States (including Florida). The integrated offering was conducted through the use of sales seminars, "road shows," and meetings directed at potential offerees and purchasers;

c. The integrated offering involved offers to tens of thousands of offerees and purchases by thousands of offerees involving sums of money, in approximately $1 billion, far in excess of that disclosed to the SEC Form D filing with the SEC. The integrated offering involved offers to, and purchases by, at least thousands of investors in the United States (including Florida residents) or those otherwise subject to Florida law;

d. The aggregate size of the sales of FPCMs and Fund investments during this period was in excess of $1 billion. The number of investors purchasing the FPCMs and Fund investments in the United States under the Reg. D filing was far in excess of 1,000;

e. The offering was made to investors with whom Defendants had no pre-existing relationship, through brokers or affiliates of Woodbridge who were paid substantial and excessive undisclosed commissions in connection with the Notes; and

f. The offering was made to persons who did not qualify as "accredited United States investors"; and far more than 35 persons who did not qualify as "accredited United States investors" purchased the Notes.

172. The FPCMs and Fund investments and transactions are not exempt from registration under the Act, nor were the Notes properly registered as required.

173. Section 517.211 renders jointly and severally liable each person making the sale "and every director, officer, partner or agent of or for the seller if the director, officer, partner or agent has personally participated or aided in making the sale."

174. The Kornfeld Defendants acted as an agent for the sellers of FPCMs and Fund investments and their affiliated entities, and the Kornfeld Defendants personally participated in and/or aided in the sale of FPCMs and Fund investments with knowledge that the offer was not exempt from Florida and federal registration requirements.

175. Pursuant to section 517.211, Florida Statutes, Plaintiffs Paul and Carla Honig, David and Carolyn Lippman and John Hertvik and members of the class are entitled to rescission and actual damages together with interest thereon.

COUNT X
Sale of Unregistered Securities in Violation of Chapter 517, Florida Statutes
(Plaintiff Roy against the Klager Sales Agent Defendants)

176. Plaintiffs re-allege the allegations set forth in Paragraph 1 through 129, as if fully set forth herein.

177. This is a claim by Plaintiff Gerald Roy against the Klager Sales Agent Defendants for violations of Chapter 517 of the Florida Act arising from the sale of unregistered securities in the state of Florida.

178. The Klager Sales Agent Defendants' offers of FPCMs and Fund investments violated section 517.211, Florida Statutes, which provides a private right of action for violations of section 517.07, Florida Statutes.

179. Section 517.07 provides that "[i]t is unlawful and a violation of this chapter for any person to sell or offer to sell a security within this state" unless the security or transaction is "exempt" under Chapter 517, or unless the security is "registered pursuant to this chapter."

180. The FPCMs and Fund investments are securities as defined in section 517.021(21), Florida Statutes.

181. Despite attempts to evade compliance with registration requirements by claiming a Regulation D exemption, the nation-wide offering of FPCMs and Fund investments to purportedly "accredited" U.S. investors was in fact an unregistered public offering made in violation of state and federal securities laws. It was an integrated offering under the securities laws, and, on information and belief, involved each of the following factors that made it a public offering and not a private offering exempt from registration:

a. The integrated offering involved general solicitation. This general solicitation by Woodbridge affiliates, agents and brokers, included general public advertisements,

publicly distributed magazine articles, television and other communications and media published in print throughout the country, including in Florida, and distributed broadly for general distribution in the United States, including in Florida.

b. The integrated offering involved general solicitation through television advertisement, internet advertisement, seminars and meetings conducted in the United States (including Florida). The integrated offering was conducted through the use of sales seminars, "road shows," and meetings directed at potential offerees and purchasers.

c. The integrated offering involved offers to tens of thousands of offerees and purchases by thousands of offerees involving sums of money, in approximately $1 billion, far in excess of that disclosed to the SEC Form D filing with the SEC. The integrated offering involved offers to, and purchases by, at least thousands of investors in the United States (including Florida residents) or those otherwise subject to Florida law.

d. The aggregate size of the sales of FPCMs and Fund investments during this period was in excess of $1 billion. The number of investors purchasing the FPCMs and Fund investments in the United States under the Reg. D filing was far in excess of 1,000.

e. The offering was made to investors with whom Defendants had no pre-existing relationship, through brokers or affiliates of Woodbridge who were paid substantial and excessive undisclosed commissions in connection with the Notes.

f. The offering was made to persons who did not qualify as "accredited United States investors"; and far more than 35 persons who did not qualify as "accredited United States investors" purchased the Notes.

182. The FPCMs and Fund investments and transactions are not exempt from registration under the Act, nor were the Notes properly registered as required.

183. Section 517.211 renders jointly and severally liable each person making the sale "and every director, officer, partner or agent of or for the seller if the director, officer, partner or agent has personally participated or aided in making the sale."

184. The Klager Defendants acted as an agent for the sellers of FPCMs and Fund investments and their affiliated entities, and the Klager Defendants personally participated in and/or aided in the sale of FPCMs and Fund investments with knowledge that the offer was not exempt from Florida and federal registration requirements.

185. Pursuant to section 517.211, Florida Statutes, Plaintiff Gerald Roy and members of the class are entitled to rescission and actual damages together with interest thereon.

COUNT XI
Sale of Unregistered Securities in Violation of Chapter 517, Florida Statutes
(Plaintiff Nanavaty against the Knowles System Sales Agent Defendants)

186. Plaintiffs re-allege the allegations set forth in Paragraph 1 through 129, as if fully set forth herein.

187. This is a claim by Plaintiff Hemant Nanavaty against the Knowles System Sales Agent Defendants for violations of Chapter 517 of the Florida Act arising from the sale of unregistered securities in the state of Florida.

188. The Knowles System Sales Agent Defendants' offers of FPCMs and Fund investments violated section 517.211, Florida Statutes, which provides a private right of action for violations of section 517.07, Florida Statutes.

189. Section 517.07 provides that "[i]t is unlawful and a violation of this chapter for any person to sell or offer to sell a security within this state" unless the security or transaction is "exempt" under Chapter 517, or unless the security is "registered pursuant to this chapter."

190. The FPCMs and Fund investments are securities as defined in section 517.021(21), Florida Statutes.

191. Despite attempts to evade compliance with registration requirements by claiming a Regulation D exemption, the nation-wide offering of FPCMs and Fund investments to purportedly "accredited" U.S. investors was in fact an unregistered public offering made in violation of state and federal securities laws. It was an integrated offering under the securities laws, and, on information and belief, involved each of the following factors that made it a public offering and not a private offering exempt from registration:

a. The integrated offering involved general solicitation. This general solicitation by Woodbridge affiliates, agents and brokers, included general public advertisements, publicly distributed magazine articles, television and other communications and media published in print throughout the country, including in Florida, and distributed broadly for general distribution in the United States, including in Florida.

b. The integrated offering involved general solicitation through television advertisement, internet advertisement, seminars and meetings conducted in the United States (including Florida). The integrated offering was conducted through the use of sales seminars, "road shows," and meetings directed at potential offerees and purchasers.

c. The integrated offering involved offers to tens of thousands of offerees and purchases by thousands of offerees involving sums of money, in approximately $1 billion, far in excess of that disclosed to the SEC Form D filing with the SEC. The integrated offering involved offers to, and purchases by, at least thousands of investors in the United States (including Florida residents) or those otherwise subject to Florida law.

d. The aggregate size of the sales of FPCMs and Fund investments during this period was in excess of $1 billion. The number of investors purchasing the FPCMs and Fund investments in the United States under the Reg. D filing was far in excess of 1,000.

e. The offering was made to investors with whom Defendants had no pre-existing relationship, through brokers or affiliates of Woodbridge who were paid substantial and excessive undisclosed commissions in connection with the Notes.

f. The offering was made to persons who did not qualify as "accredited United States investors"; and far more than 35 persons who did not qualify as "accredited United States investors" purchased the Notes.

192. The FPCMs and Fund investments and transactions are not exempt from registration under the Act, nor were the Notes properly registered as required.

193. Section 517.211 renders jointly and severally liable each person making the sale "and every director, officer, partner or agent of or for the seller if the director, officer, partner or agent has personally participated or aided in making the sale."

194. The Knowles System Defendants acted as an agent for the sellers of FPCMs and Fund investments and their affiliated entities, and the Knowles System Defendants personally participated in and/or aided in the sale of FPCMs and Fund investments with knowledge that the offer was not exempt from Florida and federal registration requirements.

195. Pursuant to section 517.211, Florida Statutes, Plaintiff Hemant Nanavaty and members of the class are entitled to rescission and actual damages together with interest thereon.

COUNT XII
Sale of Unregistered Securities in Violation of Chapter 517, Florida Statutes
(Plaintiff Nanavaty against Defendant Goodman)

196. Plaintiffs re-allege the allegations set forth in Paragraph 1 through 129, as if fully set forth herein.

197. This is a claim by Plaintiff Hemant Nanavaty against Defendant Goodman for violations of Chapter 517 of the Florida Act arising from the sale of unregistered securities in the state of Florida.

198. Defendant Goodman's offers of FPCMs and Fund investments violated section 517.211, Florida Statutes, which provides a private right of action for violations of section 517.07, Florida Statutes.

199. Section 517.07 provides that "[i]t is unlawful and a violation of this chapter for any person to sell or offer to sell a security within this state" unless the security or transaction is "exempt" under Chapter 517, or unless the security is "registered pursuant to this chapter."

200. The FPCMs and Fund investments are securities as defined in section 517.021(21), Florida Statutes.

201. Despite attempts to evade compliance with registration requirements by claiming a Regulation D exemption, the nation-wide offering of FPCMs and Fund investments to purportedly "accredited" U.S. investors was in fact an unregistered public offering made in violation of state and federal securities laws. It was an integrated offering under the securities laws, and, on information and belief, involved each of the following factors that made it a public offering and not a private offering exempt from registration:

a. The integrated offering involved general solicitation. This general solicitation by Woodbridge affiliates, agents and brokers, included general public advertisements,

publicly distributed magazine articles, television and other communications and media published in print throughout the country, including in Florida, and distributed broadly for general distribution in the United States, including in Florida.

b. The integrated offering involved general solicitation through television advertisement, internet advertisement, seminars and meetings conducted in the United States (including Florida). The integrated offering was conducted through the use of sales seminars, "road shows," and meetings directed at potential offerees and purchasers.

c. The integrated offering involved offers to tens of thousands of offerees and purchases by thousands of offerees involving sums of money, in approximately $1 billion, far in excess of that disclosed to the SEC Form D filing with the SEC. The integrated offering involved offers to, and purchases by, at least thousands of investors in the United States (including Florida residents) or those otherwise subject to Florida law.

d. The aggregate size of the sales of FPCMs and Fund investments during this period was in excess of $1 billion. The number of investors purchasing the FPCMs and Fund investments in the United States under the Reg. D filing was far in excess of 1,000.

e. The offering was made to investors with whom Defendants had no pre-existing relationship, through brokers or affiliates of Woodbridge who were paid substantial and excessive undisclosed commissions in connection with the Notes.

f. The offering was made to persons who did not qualify as "accredited United States investors"; and far more than 35 persons who did not qualify as "accredited United States investors" purchased the Notes.

202. The FPCMs and Fund investments and transactions are not exempt from registration under the Act, nor were the Notes properly registered as required.

203. Section 517.211 renders jointly and severally liable each person making the sale "and every director, officer, partner or agent of or for the seller if the director, officer, partner or agent has personally participated or aided in making the sale."

204. Defendant Goodman personally participated in and/or aided in the sale of FPCMs and Fund investments with knowledge that the offer was not exempt from Florida and federal registration requirements.

205. Pursuant to section 517.211, Florida Statutes, Plaintiff Hemant Nanavaty and members of the class are entitled to rescission and actual damages together with interest thereon.

COUNT XIII
Civil Conspiracy
(All Plaintiffs against all Sales Agent Defendants)

206. Plaintiffs re-allege the allegations set forth in Paragraph 1 through 129, as if fully set forth herein.

207. Beginning in or prior to 2012, Woodbridge, Shapiro, Roseman and the other Woodbridge insiders embarked on a civil conspiracy whereby they agreed to engage in the unlawful sale of unregistered securities to investors throughout the United States, including investors in Florida, as more fully described in detail herein.

208. As a central component of the conspiracy, the Woodbridge insiders recruited and compensated (via unlawful commissions) a network of several hundred external sales agents to solicit the purchase and sale of unregistered securities to the investing public, including the Plaintiffs.

209. Each of the Sales Agent Defendants reached and entered into an express or tacit agreement with Woodbridge, Shapiro and Roseman to solicit and sell unregistered Woodbridge securities to the investing public, including the Plaintiffs.

210. The Sales Agent Defendants' agreement to join and participate in the Woodbridge civil conspiracy is evidenced by the undisputed fact that (a) each such Sales Agent Defendant entered into a relationship with Woodbridge to act as a sales agent on behalf of the company; (b) each Sales Agent Defendant was authorized by Woodbridge to act in the capacity as a sales agent on behalf of the company; (c) each Sales Agent Defendant solicited and sold unregistered Woodridge securities to the investing public; and (d) each Sales Agent Defendant received compensation from Woodbridge in the form of unlawful commissions paid in violation of federal and state securities laws. *See, e.g.*, Declaration of Patricia Soto, Exhibit 93 to the Memorandum of Law in Support of the SEC's *Ex Parte* Emergency Motion for Asset Freeze and other Relief [DE] and Notice of Filing in support thereof [DE 36] in the related SEC Action (attesting to the various Sales Agent Defendants solicitation of investors in Woodbridge's unregistered securities and their respective lack of registration to sell securities).

211. Simply stated, the unlawful acts that Woodbridge, Shapiro, Roseman and each of the Sales Agent Defendants agreed to do was (a) to engage in the sale of unregistered Woodbridge securities which each Sales Agent Defendant knew was unlawful and (b) to receive and accept selling compensation in the form of commissions paid in violation of federal and state securities laws. In addition, many of the Sales Agent Defendants (with the exceptions of Defendants Raines, HD Vest, Helgeson, Kovac Securities, Ouelette, PanthRex, Wieniewitz and Wieniewitz Wealth) each committed an additional unlawful act by engaging in the sale of Woodbridge securities without being properly registered and licensed by FINRA, the SEC or state securities regulators, all in violation of state and federal securities laws. *See, e.g.*, Declaration of Patricia Soto, *supra*.

212. Each Sales Agent Defendant committed an overt act in furtherance of the conspiracy by selling unregistered Woodbridge securities in violation of state and federal securities

laws and receiving substantial illicit and unlawful commissions that Woodbridge paid them for each sale of an unregistered Woodbridge security. Indeed, the Sales Agent Defendants collectively received millions of dollars in sales-based commissions to motivate and incentivize them to commit these overt acts in further of the Woodbridge civil conspiracy.

213. The Woodbridge conspiracy was – by design, operation and execution – a classic "hub and spoke" civil conspiracy, with Woodbridge, Shapiro and Roseman acting as the "hub" of the conspiracy and each Sales Agent Defendant serving as an essential "spoke" through which the unlawful acts and means were accomplished in Florida and nationwide.

214. Each of the Sales Agent Defendant co-conspirators were at least generally aware of the other "spokes" in the Woodbridge conspiracy, as evidenced by the fact that (a) each Sales Agent Defendant knew the unregistered Woodbridge securities were being marketed and sold throughout the United States by other external sales agents of Woodbridge who had the same agreement with Woodbridge (*i.e.*, the sale of Woodbridge investments in exchange for commissions); (b) Shapiro and Roseman jointly communicated (via emails and conference calls) with the Sales Agent Defendants on a regular basis regarding the need to solicit and sell the unregistered Woodbridge securities; (c) Shapiro and Roseman invited the Sales Agent Defendants to visit its headquarters to view its operations and network with other sales agents; and (d) Shapiro and Roseman hosted lavish parties and events which the Sales Agent Defendants were invited to attend and which were designed to pitch the sale of unregistered Woodbridge securities and to motivate and incentivize the Sales Agent Defendants' ongoing participation in the conspiracy.

215. Woodbridge, Shapiro and Roseman also established the "Pass It On" program through which the Sales Agent Defendants were encouraged to inform their colleagues about the

FPCM notes and thereby earn 25 basis points on each FPCM sale closed by another sales agent whom he or she referred.

216. The existence of the Woodbridge civil conspiracy that each Sales Agent Defendant agreed to join and commit overt unlawful acts in furtherance of is also evidenced by a May 4, 2016 email that Shapiro sent to Roseman complaining about his "sales force's" lack of effort and production, to which Roseman relied that "my team is not lazy" and that "our 3 main brokers Knowles [*i.e.*, Defendants Robbins, Leutz and Knowles Systems], live abundant [*i.e.*, External Sales Agent Defendants Andrew and Paramount] and kornfeld [*i.e.*, Defendants Barry and Ferne Kornfeld] are all slow at the moment and it is effecting our numbers . . . ." This document thus evidences both the existence of the conspiracy to sell unregistered securities and the critical and essential role that the Sales Agent Defendants played in furtherance of the conspiracy.

217. The tortious conduct and overt acts committed by the Sales Agent Defendants in furtherance of the Woodbridge civil conspiracy have caused Plaintiffs and putative class members substantial damages estimated to be at least $961 million in principal as a result of the loss of their investment and retirement funds.

218. As a matter of law, each co-conspirator Sales Agent Defendants is jointly and severally liable for the damages caused by the conduct of the other members of the conspiracy occurring at any time prior to and after its joinder of the conspiracy, and continuing until the time that such co-conspirator unequivocally withdraws from the conspiracy.

219. The tortious and wrongful conduct committed by each of the individual co-conspirator Sales Agent Defendants named in this action has caused Plaintiffs to become embroiled in litigation with the other co-conspirators, requiring Plaintiffs to incur actual attorneys' fees and expenses in protecting its interests against the other co-conspirators. Pursuant to the third-

party litigation exception to the American Rule of attorneys' fees, Plaintiffs are entitled to recover from each co-conspirator Sales Agent Defendants the actual attorneys' fees and costs incurred in protecting Plaintiffs' interests against the other co-conspirators, as additional compensatory damages.

COUNT XIV
Civil Conspiracy
(Plaintiff Nanavaty against Knowles System Sales Agent Defendants and Goodman)

220. Plaintiffs re-allege the allegations set forth in Paragraph 1 through 129, as if fully set forth herein.

221. Beginning in or prior to March 2014, the Knowles System Sales Agent Defendants embarked on a civil conspiracy whereby they each entered into an express or tacit agreement with Woodbridge, Shapiro and Roseman and with one another to solicit and sell unregistered Woodbridge securities to the investing public, including Plaintiff Nanavaty, as more fully described in detail herein.

222. The Knowles System Sales Agent Defendants' agreement to join and participate in the civil conspiracy with Woodbridge, Shapiro and Roseman is evidenced by the undisputed fact that (a) the Knowles System and its agents were authorized by Woodbridge to act in the capacity as sales agents on behalf of the company; (b) the Knowles System Sales Agent Defendants solicited and sold unregistered Woodridge securities to the investing public; and (c) Knowles System Sales Agent Defendants received compensation from Woodbridge in the form of unlawful commissions paid in violation of federal and state securities laws. *See, e.g.*, Declaration of Patricia Soto, Exhibit 93 to the Memorandum of Law in Support of the SEC's *Ex Parte* Emergency Motion for Asset Freeze and other Relief and Notice of Filing in support thereof [DE 36] in the related

SEC Action (attesting to the Knowles Systems, Robbins and Leutz' solicitation of investors in Woodbridge's unregistered securities and their respective lack of registration to sell securities).

223. Simply stated, the unlawful acts that the Knowles System Sales Agent Defendants agreed to do was (a) to engage in the sale of unregistered Woodbridge securities which they knew was unlawful and (b) to receive and accept selling compensation in the form of unlawful commissions paid in violation of federal and state securities laws. In addition, the Knowles System Sales Agent Defendants each committed an additional unlawful act by engaging in the sale of Woodbridge securities without being properly registered and licensed by FINRA, the SEC or state securities regulators, all in violation of state and federal securities laws. *See, e.g.*, Declaration of Patricia Soto, *supra*.

224. The existence of the Knowles System Sales Agent Defendants' joinder in the Woodbridge civil conspiracy is evidenced by a May 4, 2016 email that Shapiro sent to Roseman complaining about his "sales force's" lack of effort and production, to which Roseman relied that "my team is not lazy" and that "our 3 main brokers **Knowles** [*i.e.*, Defendants Robbins, Leutz and Knowles Systems] . . . are all slow at the moment and it is effecting our numbers . . . ." This document thus evidences both the existence of the Knowles System Sales Agent Defendants civil conspiracy to sell unregistered securities and the critical and essential role that the Knowles System Sales Agent Defendants played in furtherance of the conspiracy.

225. The Woodbridge conspiracy was – by design, operation and execution – a classic "hub and spoke" civil conspiracy, with Woodbridge, Shapiro and Roseman acting as the "hub" of the conspiracy and the Knowles System Sales Agent Defendants serving as an essential "spoke" through which the unlawful acts and means were accomplished in Florida and nationwide.

226. The Knowles System Sales Agent Defendants each committed an overt act in furtherance of the conspiracy by selling unregistered Woodbridge securities in violation of state and federal securities laws and receiving substantial illicit and unlawful commissions that Woodbridge paid them for each sale of an unregistered Woodbridge security.

227. Defendant Goodman agreed to join and participate in the Woodbridge conspiracy by materially aiding the Knowles System Sales Agent Defendants and by participating in the unlawful sale of unregistered securities in exchange for 1/3 of the commissions paid to Knowles Systems Sales Agent Defendants for each investor solicited and referred by Goodman.

228. Defendant Goodman engaged in overt acts in furtherance of the civil conspiracy by pitching Woodbridge as a safe and secure investment during his regular guest appearances on numerous financial radio call-in shows across the country; by referring potential investors who responded to his solicitation to Knowles Systems, Robbins and Leutz; and by accepting 1/3 of the commissions paid to Knowles Systems, Robbins and Leutz in connection with such sales of unregistered securities. Goodman also participated in furtherance of the civil conspiracy in a pod-cast posted on Knowles Systems' website in which he interviewed Robbins and recommended the Woodbridge investments pitched by the Knowles System Sales Agent Defendants.

229. In this manner, Plaintiff Nanavaty was directly solicited and inducted by Goodman to purchase unregistered Woodbridge securities.

230. The Knowles System Sales Agent Defendants, with the substantial aid and assistance of Goodman, raised approximately $147 million in principal through the sale of Woodbridge investments to more than 540 retail investors and were paid in excess of $8 million in commissions by Woodbridge utilized investor funds. *See, e.g., SEC v. Lynette M. Robbins and Knowles Systems, Inc.*, Case No. 1:18-23368 (S.D. Fla.) (the "SEC Knowles Systems Action").

231. The tortious conduct and overt acts committed by the Knowles System Sales Agent Defendants and Goodman have caused Plaintiff Nanavaty and putative class members substantial damages estimated to be at least $961 million in principal as a result of the loss of their investment and retirement funds.

232. As a matter of law, the Knowles System Sales Agent Defendants and Goodman are each co-conspirator is jointly and severally liable for the damages caused by the conduct of the other members of the conspiracy occurring at any time prior to and after its joinder of the conspiracy, and continuing until the time that such co-conspirator unequivocally withdraws from the conspiracy.

233. The tortious and wrongful conduct committed by each of the Knowles System Sales Agent Defendants and Goodman as co-conspirators has caused Plaintiffs to become embroiled in litigation with the other co-conspirators, requiring Plaintiffs to incur actual attorneys' fees and expenses in protecting its interests against the other co-conspirators. Pursuant to the third-party litigation exception to the American Rule of attorneys' fees, Plaintiffs are entitled to recover from each co-conspirator Knowles System Sales Agent Defendants the actual attorneys' fees and costs incurred in protecting Plaintiffs' interests against the other co-conspirators, as additional compensatory damages.

Count XV
Vicarious Liability
(All Plaintiffs against Corporate Defendants)

234. Plaintiffs re-allege the allegations set forth in Paragraph 1 through 129, as if fully set forth herein.

235. Defendants Barry and Ferne Kornfeld were employed by, an officer of, or affiliated with Defendants First Financial and FEK Enterprises and acting within the course and scope of

their actual agency with First Financial and FEK Enterprises at all times material to this action. Indeed, First Financial and FEK Enterprises were closely held and/or solely owned by Defendants Barry and Ferne Kornfeld, and as such they authorized themselves to act as actual agents of their corporate entities. First Financial and FEK Enterprises thus acknowledged that Barry and Ferne Kornfeld would act on the entities' behalf; Barry and Ferne Kornfeld accepted the undertaking to act as agents for First Financial and FEK Enterprises; and First Financial and FEK Enterprises controlled the actions of Barry and Ferne Kornfeld.

236. Defendants Robbins, Leutz and Goodman were employed by, an officer of, or affiliated with Defendant Knowles Systems and acting within the course and scope of their actual agency with Knowles Systems at all times material to this action. Indeed, Knowles Systems was closely held and/or solely owned by Defendants Robbins and Leutz, and as such they authorized themselves to act as actual agents of their corporate entity. Knowles Systems thus acknowledged that Robbins and Leutz would act on the entity's behalf; Robbins and Leutz accepted the undertaking to act as agents for Knowles Systems; and Knowles Systems controlled the actions of Robbins and Leutz.

237. Defendants Al and Michelle Klager were employed by, an officer of, or affiliated with Defendant Atlantic and acting within the course and scope of their actual agency with Atlantic at all times material to this action. Indeed, Atlantic was closely held and/or solely owned by Defendants Al and Michelle Klager, and as such they authorized themselves to act as actual agents of their corporate entities. Atlantic thus acknowledged that Al and Michelle Klager would act on the entity's behalf; Al and Michelle Klager accepted the undertaking to act as agents for Atlantic; and Atlantic controlled the actions of Barry and Ferne Kornfeld.

238. Defendant Gilchrist was employed by, an officer of, or affiliated with Defendant Florida Tax and acting within the course and scope of his actual agency with Florida Tax at all times material to this action. Indeed, Florida Tax was closely held and/or solely owned by Defendants Gilcrest, and as such he authorized himself to act as an actual agent of his corporate entities. Florida Tax acknowledged that Gilchrist would act on the entity's behalf; Gilchrist accepted the undertaking to act as an agent for Florida Tax; and Florida Tax controlled the actions of Gilchrist.

239. Defendant Hannah was employed by, an officer of, or affiliated with Defendant Retirement Planning and acting within the course and scope of his actual agency with Retirement Planning at all times material to this action. Indeed, Retirement Planning was closely held and/or solely owned by Defendant Hannah, and as such he authorized himself to act as an actual agent of his corporate entity. Retirement Planning thus acknowledged that Hannah would act on the entity's behalf; Hannah accepted the undertaking to act as an agent for Retirement Planning; and Retirement Planning controlled the actions of Hannah.

240. Defendant Andrew was employed by, an officer of, or affiliated with Defendant Paramount and acting within the course and scope of his actual agency with Paramount at all times material to this action. Indeed, Paramount was closely held and/or solely owned by Defendant Andrew, and as such he authorized himself to act as an actual agent of his corporate entity. Paramount thus acknowledged that Andrew would act on the entity's behalf; Andrew accepted the undertaking to act as an agent for Paramount; and Paramount controlled the actions of Andrew.

241. Defendants David, MacKenzie and Burke were employed by, officers of, or affiliated with Defendant Old Security and acting within the course and scope of their actual agency with Old Security at all times material to this action. Indeed, Old Security was closely held

and/or solely owned by Defendants David, MacKenzie and Burke, and as such they authorized themselves to act as actual agents of their corporate entity. Old Security thus acknowledged that David, MacKenzie and Burke would act on the entities' behalf; David, MacKenzie and Burke accepted the undertaking to act as agents for First Old Security; and Old Security controlled the actions of David, MacKenzie and Burke.

242. Defendant Helgeson was employed by or affiliated with Defendant Kovac Securities as a registered representative of the firm and acting within the course and scope of his actual agency with Kovac Securities at all times material to this action. Kovac Securities acknowledged that Helgeson would act on the entity's behalf; Helgeson accepted the undertaking to act as an agent for Kovac Securities; and Kovac Securities controlled the actions of Helgeson.

243. Defendant Raines was employed by or affiliated with Defendant HD Vest as a registered representative of the firm and acting within the course and scope of his actual agency with HD Vest at all times material to this action. HD Vest acknowledged that Raines would act on the entity's behalf; Raines accepted the undertaking to act as an agent for HD Vest; and HD Vest controlled the actions of Raines.

244. Defendant Ouelette was employed by or affiliated with Defendants Shield Financial and PanthRex as an investment advisor of the firms and acting within the course and scope of his actual agency with Shield Financial and PanthRex at all times material to this action. Shield Financial and PanthRex acknowledged that Ouelette would act on the entities' behalf; Ouelette accepted the undertaking to act as an agent for Shield Financial and PanthRex; and Shield Financial and PanthRex controlled the actions of Ouelette.

245. Defendant Wieniewitz was employed by or affiliated with Defendant Wieniewitz Wealth as an investment advisor of the firm and acting within the course and scope of his actual

agency with Wieniewitz Wealth at all times material to this action. Indeed, Wieniewitz Wealth is closely held and/or solely owned by Defendant Wieniewitz, and as such he authorized himself to act as an actual agent of his corporate entities. Wieniewitz Wealth thus acknowledged that Wieniewitz would act on the entity's behalf; Wieniewitz accepted the undertaking to act as an agent for Wieniewitz Wealth; and Wieniewitz Wealth controlled the actions of Wieniewitz.

246. Defendants First Financial, FEK Enterprises, Knowles Systems, Atlantic, Florida Tax, Retirement Solutions, Paramount, Old Security, Kovak Securities, HD Vest, Shield Financial, PanthRex, and Wieniewitz Wealth are vicariously liable for all damages or relief awarded as a result of the tortious conduct of their respective affiliated Sales Agent Defendants as alleged herein, each of whom were acting within the course and scope of their actual or apparent agency.

COUNT XVI
Negligence
(All Plaintiffs against GBH CPAS)

247. Plaintiffs re-allege Paragraphs 1 through 129, and incorporate the same as if fully set forth herein.

248. GBH CPAS owed Plaintiffs a duty of care. GBH CPAS knew that its work on behalf of Woodbridge would be relied upon, directly or indirectly, by Plaintiffs in deciding to make or retain investments in Woodbridge. Among other things, GBH CPAS knew Woodbridge would use its work to represent to third parties, including investors like Plaintiffs, that Woodbridge could generate sufficient cash flows to repay investors and that it was otherwise a going concern.

249. GBH CPAS breached its duty of care to Plaintiffs and was negligent in providing accounting services. GBH CPAS failed to properly prepare Woodbridge financial statements in accordance with applicable accounting standards. GBH CPAS also ignored numerous red flags concerning Woodbridge, the FPCMs, or the Fund Offerings, including that:

a. The Woodbridge Investment Companies' revenue consisted mostly of intercompany receivable transactions, but this was not reflected by corresponding cash receipts in the Woodbridge operating accounts or journal entries in the Woodbridge Investment Companies' financial statements;

b. The Woodbridge Investment Companies recorded assets that were duplicative of the Woodbridge operating accounts' assets;

c. The account transactions in the Woodbridge Investment Companies' accounts were highly unusual, and in most cases consisted of investor funds being received, and then immediately transferred to the Woodbridge operating accounts;

d. There was minimal cash actually received from borrowers for mortgage interest payments, which was the purported source of the Woodbridge FPCM payments and the supposed basis for the entire Woodbridge business model; and

e. There was extensive commingling of funds between the Woodbridge entities, which totaled approximately $1.66 billion.

251. GBH CPAS's breach of its duty of care directly and proximately caused the Plaintiffs to sustain significant damages.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs, on behalf of themselves and all similarly situated individuals, demands judgment against Defendants as follows:

(1) a determination that this action be certified as a class action and that Plaintiffs be designated as class representatives under Rule 23 of the Federal Rules of Civil Procedure and Plaintiffs' counsel be designated as class counsel;

(2) awarding Plaintiffs and the Class compensatory damages in an amount to be

determined at trial, including interest;

(3) awarding Plaintiffs and the Class the reasonable costs and expenses incurred in this action, including attorneys' fees and expert fees;

(4) awarding such other relief that is just, proper, and equitable.

DEMAND FOR JURY TRIAL

Plaintiff and the Class request a jury trial for any and all claims for which a jury trial is permitted by law.

Dated: August 29, 2018.

By: */s/ Jonathan B. Butler*
Jonathan B. Butler (FBN 056197)
JButler@ciklinlubitz.com
CIKLIN LUBITZ & O'CONNELL
515 North Flagler Drive, 20th Floor
West Palm Beach, FL 33401
T: (561) 832-5900
F: (561) 833-4209
Co-Counsel for Plaintiffs

-and-

Joseph G. Galardi (FBN 180572)
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James W. Beasley, Jr. (FBN 145750)
beasley@beasleylaw.net
Andrew S. Kwan (FBN 76539)
kwan@beasleylaw.net
BEASLEY & GALARDI, P.A.
505 South Flagler Drive, Suite 1500
West Palm Beach, Florida 33401
T: (561) 835-0900
F: (561) 833-4209
Co-Counsel for Plaintiffs

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that the foregoing document was electronically filed with the Clerk of the Court and served on all parties via CM/ECF on this 29th day of August, 2018.

/s/ Jonathan B. Butler
Jonathan B. Butler

Liquidity Page 5

EQUIALT



Alternative Investment Strategies

Creating Viable Solutions For YOU

1-855-EquiAlt | www.EquiAlt.com

Exhibit H

EQUIALT LLC & SUBSIDIARIES Las Vegas | Phoenix | Tampa Area



As life changes...



so do your goals.



We can help.

EquiAlt Overview

We understand that there are several strategies and goals in the area of Real Estate investing. Based on our experience, we offer education and offerings that are truly investment grade. Available products for investors range from totally passive to the traditional active.



EQUITY

EquiAlt researches, acquires and manages opportunistic and distressed Real Estate assets for the income and equity. EquiAlt's management has directly acquired over 345 million dollars and liquidated over 450 million dollars in distressed Real Estate since 2008 and over 3000 transactions.



HOLDINGS

EquiAlt maintains investment grade income property that has been stabilized from the distressed acquisitions. These specific properties are part of a convergent investment strategy based on generational demographic trends in Real Estate. These properties from time to time are offered in bulk to end investors in groups of ten units or greater.

EQUIALT

Core Values

We believe that it matters, not only what strategy the investment manager subscribes to, but perhaps more importantly, the corporate values and individual character of the team members that manage your capital.

Our core values are central to who we are individually and as a team. We are passionate about these ideas and they are the foundation that we build upon in managing this fund.



EquiAlt Highlights:

- **NO DEBT - No Third Party Risk**
- Proven Risk Management Strategies
- Invest In Tangible Assets
- Alignment of Interest with Investors
- Successful Track Record During the Downturn
- Diverse Stabilized Income Streams

Historical Performance

Historic return to investors:

- **Equialt Has NEVER Lost Investor Dollars Since Inception**
- Returns are fixed to your individual investment so you know what to expect for your portfolio
- Several versions are offered based on your needs and suitability
- Directly acquired over $345 million and liquidated over $450 million in distressed Real Estate since 2008
- Successfully completed over 3000 transactions

Fund Executive Summary

Income Producing Growth or monthly income

Leverage Zero leverage, no financing on assets inside the fund

Transparency All assets verifiable thru County Assessor sites

Private Placement Memorandum Stabilized net asset value with fixed return

Fund Terms

Terms:

Yield to Investors	8% Growth or Payment
Minimum Investment	$25,000
Maximum Size Per Fund	$150,000,000
Lock Up Period	48-72 Months
Liquidity	60 days notice
Income Distribution Options	Monthly

Service Providers:

Fund Administrator	EquiAlt, LLC
Banking	Wells Fargo

Legal
Paul R. Wassgren, Partner
DLA Piper LLP (US)
2000 Avenue of the Stars
Suite 400 North Tower
Los Angeles, California
90067-4704
(310)595-3000

CPA
Gino Mauriello & Co
5545 Mountain Vista St #E
Las Vegas, NV 89120

Strategy Overview

This aspect of the funds activity are based on Macro Demographic Trends in the United States as (in our opinion) best explained by Harry S. Dent.

Value:

- Equity on acquisition (not relying on future appreciation) or speculation
- Fixed assets providing cash flow
- Real Estate as an inflation hedge
- Product is currently attractive for 'non-wealthy' boomers who retire en masse until 2024 who still want independence of separate living conditions without the burden of ownership
- Product is attractive for 'echo boomers' as first time buyers as an exit strategy
- End product is attractive to institutional investors buying pools of performing assets

Risk:

- Assets are significantly distressed, physically unstable with title work to complete to make fully marketable in traditional sales outlets such as MLS through Realtors
- Average repair per unit is 20% of current value.

Value does not account for the recent full repairs that make our product above market value as an updated new, fully repaired product

Summary:

EquiAlt is currently focused in the Single Family Market and Small Multi-Unit Properties, as the market is tightening we are branching out to more aggressive bidding towards higher volume purchases. As the market strengthens, this will include apartment complexes and condo units. EquiAlt's goal has always been to add to our base, while maintaining a "no-debt" platform, minimizing market exposure, and securing a fixed income as monthly cash flow.

By acquiring and maintaining what most demographic research points to as generally the brightest potential area in all Real Estate, management hopes to provide current and future value.

Why EquiAlt?

- Depth of experience in Real Estate lending markets
- Successfully liquidated over $450 million in distressed Real Estate since 2008
- Over 3000 successful transactions
- Nationwide capabilities, able and ready for all markets
- Direct alignment with our clients
- Highly seasoned team of investment professionals
- Conservative underwriting methodology
- Reg D Fund offering, on file with SEC
- Currently operating three successful private placement funds
- One of a few management teams that have operated successfully throughout the downturn of our "great recession"

Strategy Overview

Key Points:

- Primary risk management tool: conservative underwriting
- Sector and property diversification: key to managing risk within portfolio
- Senior management inspects every property before purchase
- Preference for income producing properties
- Maximum exposure is less than 70% current market value

Investment Ideas; Better Investor Positioning:

Opportunity to make investments in whole distressed Single Family Real Estate focused on equity on acquisition buying and buy-to-rent strategies. This investment strategy positions the investment for several factors from a strong buy side positioning allowing for:

1. Assets are bought significantly under current value:

The 2012 average acquisition price was 31% of current value, significantly more equity than the average distressed unit in US. Properties are purchased individually to increase the equity on acquisition as bulk buying masks the laggards in a group. This practice significantly reduces principle risk and allows for much higher than normal ROI from the market rents compared to actual cash outlay.

2. Asset are immediately brought to cash flowing: (28 day average). Upon acquisition every property is addressed for any necessary rehabilitation to stabilize and repair the property to make it a marketable residence.

3. Assets are targeted toward specific end users:

- Aging baby boomers, manageable size property, SFR freedom, SFR quality, a more stable fixed income renter.
- Echo Boomers are the next significant generational consumer wave; more rent type options; rent, rent to own, lease option, financed, all for the future first time homebuyers.

4. Assets are non-leveraged:

Properties carry no debt burden. This allows for higher yield to investors and increased management flexibility in down markets.

5. Multiple exit strategies:

Units exist in the market as fully repaired, modernized functioning cash flowing assets. These can be sold individually or in blocks to institutional investors.

Strategy Overview

Forced Pragmatism vs. American Dream: Rent VS. Own

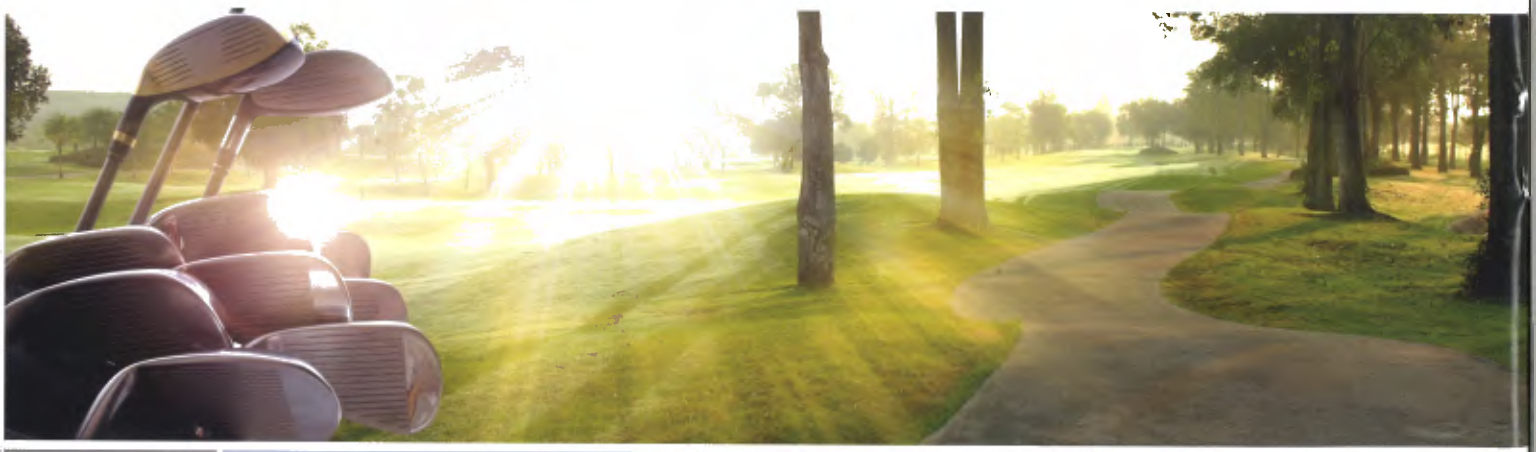
Real Cost Of Home Ownership: With no home price appreciation prospective buyers analyze all cost of ownership; property taxes, HOA dues, maintenance / repair costs. Notable: property taxes will be under pressure as municipalities look to raise rates to balance stressed budgets. Transaction costs; typically overlooked and take 10% off any arms length transaction -a price of mobility or cashing out.

Demographic Effects: Baby boomer households have begun the shift to empty nesters, downsizing, smaller vacation home buyers. Gen Y is growing pressing the need for entry level housing, this is an 80M-group whose job growth was 3x's the national average in 2010 and the average household size is declining as a % of households. This coupled with the psychological effect of Gen Y's raised in a housing bust should alter projections.

Economic Obstacles: Hurdles to purchasing are; real downpayment requirements, stricter FICO and underwriting guidelines. The great recession has leveled many entry level owners with damaged credit profiles and longer term unemployment have drained cash down payments. Rising student loan debt with more college graduates with more debt than previous generations pressure future purchases.

Home Price Declines 30%-50%: Historic declines have altered consumer thinking on housing as an investment. Foreclosure backlog increase fears of further value decreases discourages buyers with down payment risk.

Economic Drags: Long-term unemployment and labor insecurity raise the need for mobility. Rising gas prices along with environmental issues are increasing demand for residences close to transit and denser locations away from the metropolitan area.



Portfolio Asset Description

- Underlying assets: single family residences, multi-family, commercial
- **Zero leverage, no debt encumbrances**
- Conservative purchase-to-value– maximum 70%
- Types of Real Estate considered
  - Preference for income-producing assets
- Fund activities:
  - Primarily in high opportunistic Real Estate
  - Tax certificates
  - Tax sale properties
  - Trustee sale properties
  - Bank sale properties
  - Trust deeds
- 48 - 72 month terms



Q&A

What happens if the market repeats itself and turns back to what we saw in 2007 – 2010?
During the downturn EquiAlt's Management successfully turned over 185 properties and averaged an annual return of 24.68% from 2007 - 2010! A downturn isn't expected but if it were to happen than EquiAlt's Management is ready and has proven successfully it can make the proper decisions to turn a profitable return.

Are there individual Insurance policies or how are the properties protected from natural or unnatural disasters?
There is a blanket policy thru National Real Estate Insurance Group, Affinity Group Management to cover for such disasters.

Can I use my 401k / IRA retirement account to invest into the fund?
Yes, the account is moved into a self-directing retirement account which is than invested into EquiAlt Fund LLC. The process is simple, a form is filled out, and the money is transferred to the self-directed IRA account and then invested into EquiAlt Fund LLC. The process is handled this way to make sure there are no tax complications or charges.

Do I receive statements for my account? Yes, quarterly statements are mailed out and can be emailed on request

Can I contact EquiAlt's CPA or Attorney? Absolutely, both are independent from EquiAlt LLC and can give you some insight into the fund and its activities.

Does EquiAlt buy in blocks or in bulk?
NO! We have "Boots on the ground" which is to say we inspect each and every property before purchase to find out the pluses and negatives before we own it. We don't have any pressure to just buy property for the sake of buying property like the bigger hedge funds. We have intentionally stayed small to keep the fund you are investing in strong!

Executive Team Biographies



Brian Davison – Chief Executive Officer

Brian Davison's Real Estate career began in 1994 in North County San Diego. He has hands-on experience in a variety of functions in the Real Estate and mortgage industries: encompassing management, loan renegotiation at a publicly traded REIT, regional Vice President of a private residential mortgage company, the broker-owner of a multi-state branch correspondent residential loan origination company with in-house underwriting and outbound marketing support system, and Vice President of a private lending company. Brian has held Real Estate and/or mortgage broker licenses in California, Nevada, and Florida, with additional work in the Arizona and Colorado markets. Brian has facilitated over $1.5 billion in mortgage and Real Estate transactions, is an active investor in a variety of markets and is host of "The Cash Flow Show." In early 2009, he founded Invest REO LLC dba The Cash Flow Store, an opportunistic distressed Real Estate investment company. He currently holds a State of Nevada Real Estate License.



Barry M. Rybicki – Managing Director

Barry has over 14 years of experience in Real Estate lending. He has lived in Phoenix, Arizona for the past 21 years, originally coming to Arizona from Nebraska to attend Arizona State University where he majored in Accounting and minored in Marketing. He served as President to a bank in Arizona, and managed a $10,000,000 line of credit. This capacity required; Real Estate evaluation, risk management, customer service, underwriting, appraisal review. He has handled over $540,000,000 in residential deeds of trust in the Phoenix market and continues to have an overall understanding of the residential sectors inside of Maricopa County. Barry also served as Vice President for Cole Management LLC, where he gained significant experience in originating, structuring and negotiating deals, developing and implementing business strategies, assessing market and competitive issues, and raising capital from debt and equity providers. He remains actively involved in the community donating his time to coach youth sports and is currently the Treasurer of Pinnacle High School's Boys Soccer Team.



An alternate approach...

to Investments.





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www.EquiAlt.com

EQUIALT LLC & SUBSIDIARIES Las Vegas | Phoenix | Tampa Area

Catherine Soto

From: AuroraDonnelly@bayview1031.com
Sent: Tuesday [redacted]:55 AM
To: Catherine [redacted]
Subject: Re: Letter regarding naming of alternative property fo[redacted] EX-061214

Dear Catherine,

We are in receipt of the letter regarding the alternate property Mr. and Mrs. [redacted] were negotiating prior to the expiration of the identification period. Thank you.

Aurora Donnelly
Exchange Coordinator
Bayview Financial Exchange Services
4425 Ponce de Leon Blvd., 4th Floor
Coral Gables, Florida 33146
305-631-6319
305-646-4787 fax
866-709-3445 toll free
AuroraDonnelly@bayview1031.com

"Catherine Soto" <csoto@futureconcepts.org>

05/02/2006 09:13 AM

To: <AuroraDonnelly@bayview1031.com>
cc:
Subject: Letter regarding naming of alternative property for Schneiderman EX-061214

Good morning Aurora. I just faxed over to you the letter from [redacted] regarding the naming of an additional alternative property that the [redacted] were negotiating prior to their Identification Period ending March 25, 2006. **Please send a written confirmation that you have received this letter, since the clients are coming into the office at 11:00am and would like to see a confirmation from Bayview Financial concerning this.** Thank you.

Catherine [redacted]

[redacted]

5/2/2006

Appendix 7

LAST NAME [redacted] ICC # DEAL CXLD BY NNN 4/26/06 !!

DATE	INIT	FROM #	ACCT	ESTIMATE	TO #	ACCT	ACCT AM
3/18/06	A	Bayview Financial	TR	~~688,500~~	Triple Net Properties		
					400 W. Capitol Avenue		
	B	Bayview Financial	TR	~~688,500~~	Triple Net Properties		
					400 W. Capitol Avenue		
One Exchange			TOTAL	~~1,377,000~~	3/22 Client increased equity purchase to		$1,530,000
3/18/06	A	Bayview Financial	TR	ONE EXCHANGE	US Advisors		
	B	Bayview Financial	TR	TOTAL $1,500,000	615 North 48th Street		
5/2/06	A	Bayview Financial	TR	ONE EXCHANGE	Argus Realty Investors		
	B	Bayview Financial	TR	TOTAL $1,500,000	11 Shorenew Corporate Center $1,496,250 Equity Amount		

CXL

Phase two includes the addition of an eight-story, 380,000 square-foot tower. Phase three will add another seven-story, 300,000 square-foot tower, bringing the project's total square footage to 1.5 million square feet

BACK

http://www.bizjournals.com/twincities/stories/2005/06/27/daily14.html

Tuesday, June 28, 2005

Mounds View council OKs Medtronic site

Minneapolis / St. Paul Business Journal

- Print Article
- Email Article
- Reprints
- RSS Feeds
- ShareThis

Other Matching Articles for "Medtronic Mounds View news"

- **Ongoing M&A activity is big news in med-tech sector** [01/30/2006]
- **Calendar** [03/28/2005]
- **Insulin pump market sees entry, exit** [10/27/2003]

- **> More Search Results**

Bridges Golf Course in Mounds View will soon be paved to make way for a new **Medtronic Inc.** campus.

The Mounds View City Council voted 4 to 1 Monday night to approve the medical device maker's plan to build a $65 million corporate campus on the golf course site. The new campus, which will employ 3,200 workers, will serve as the world headquarters of Fridley-based Medtronic's (NYSE: MDT) cardiac rhythm management unit.

The company also plans to add two more buildings in the future, which would bring the Mounds View campus to 1.5 million square feet and about 6,000 employees.

http://websearch.medtronic.com/search/query.html?col=mdt1&la=&lk=1&nh=10&oq=&pw=100%25&qc=&qm=0&qp=&qs=&qt=mounds&rf=0&rq=0&st=1&submit=Search&ws=0

Medtronic Breaks Ground On New Cardiac Rhythm Management Headquarters

Initially housing more than 3,000 employees, new facility will be Medtronic's largest in the world

Mounds View, Minn. – Dec. 7, 2005 – Medtronic, Inc. (NYSE: MDT) today broke ground on the first phase of the company's new 1.5-million-square-foot headquarters campus for its Cardiac Rhythm Management (CRM) business. The ceremony took place this afternoon on the 85-acre property near Highways 10 and 35W in Mounds View, Minn. When phase one is complete, it will be the largest Medtronic facility in the world and will anchor an

Medtronic Mounds View News

http://wwwp.medtronic.com/Newsroom/NewsReleaseDetails.do?itemId=1133908307553&lang=en_US

News Release

Medtronic Media Contacts:

Rich Fischer, Public Relations, 763-505-2975

Medtronic Breaks Ground On New Cardiac Rhythm Management Headquarters

Initially housing more than 3,000 employees, new facility will be Medtronic's largest in the world

Mounds View, Minn. – Dec. 7, 2005 – Medtronic, Inc. (NYSE: MDT) today broke ground on the first phase of the company's new 1.5-million-square-foot headquarters campus for its Cardiac Rhythm Management (CRM) business. The ceremony took place this afternoon on the 85-acre property near Highways 10 and 35W in Mounds View, Minn. When phase one is complete, it will be the largest Medtronic facility in the world and will anchor an estimated $1.9 billion in new direct and indirect economic activity in Minnesota over the next seven years.

"It's always a win when we can encourage any Minnesota-based businesses to expand and grow here at home, but Medtronic is special," said Gov. Tim Pawlenty, who attended the ceremony. "Medtronic not only offers life-saving therapies for people around the world, they provide great jobs and benefits for more than

7,000 Minnesotans and their families, all while fueling the state's medical technology industry. With this expansion, we will continue to reap the benefits of Medtronic's continued growth and maintain leadership in this vital industry."

"Today marks more than the beginning of a new wonderful facility, it reflects on-going commitment to a 56-year partnership between Medtronic and the people of Minnesota," said Art Collins, Medtronic chairman and chief executive officer. "We're a Minnesota company and we're proud to embrace the ingenuity, values and work ethic that make this state great. Our roots run deep in Minnesota, and with this expansion, those roots grow even deeper."

The 820,000 square-foot, $65-million first phase will house up to 3,200 employees with an array of jobs including research and development, management, marketing, sales, finance and legal departments and all their support functions. Anchored by two eight-story buildings, the facility's first phase will be primarily dedicated to office space, but will include light mechanical, electrical and software labs to support CRM's research and development activities. Company officials anticipate the first phase will be completed in late 2007.

The facility is master planned to allow expansion up to 1.5 million square feet and could eventually house up to 6,000 employees.

"We're growing jobs in Minnesota faster than we can house the employees filling them," said Steve Mahle, executive vice president and president of Medtronic's CRM business. "The new CRM headquarters not only addresses our current and future growth, but anchors our presence in these great northern suburbs. Our new home will allow us to continue more than 50 years of work to alleviate pain, restore health, and extend life."

Medtronic currently operates 14 facilities in Minnesota with more than 7,000 full-time employees, more than half working for CRM. The company has hired more than 2,000 employees in the past five years – double its 1999 estimates – and projects to add another 285 new employees each year for the next seven years. The current average salary for Minnesota employees is $70,300, plus a competitive offering of benefits. Medtronic ranks as Minnesota's eighth largest employer among publicly-traded companies.

The Mounds View facility marks the second major expansion project in the past six years for the company. The 460,000-square-foot Corporate World Headquarters opened in Fridley in 2001.

Medtronic Cardiac Rhythm Management is the company's largest business, developing and marketing implantable pacemakers and defibrillators, monitoring and diagnostic devices and cardiac resynchronization devices, including the first implantable device for the treatment of heart failure. CRM also makes automated external defibrillators (AEDs).

About Medtronic
Medtronic, Inc. (www.medtronic.com), headquartered in Minneapolis, is the global leader in medical technology – alleviating pain, restoring health, and extending life for millions of people around the world.

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Any forward-looking statements are subject to risks and uncertainties such as those described in Medtronic's Annual Report on Form 10-K for the year ended April 29, 2005. Actual results may differ materially from anticipated results.

Editor Note: Additional media materials and facility image available at the Medtronic Newsroom (http://wwwp.medtronic.com/Newsroom/MediaKitDetails.do?itemId=1133808880199).

BACK

http://wwwp.medtronic.com/Newsroom/LinkedItemDetails.do?itemId=1133908896699&itemType=fact_sheet&lang=en_US

Fact Sheet

Medtronic Media Contacts:

Rich Fischer, Public Relations, 763-505-2975

Groundbreaking Fact Sheet Facility

MEDTRONIC CARDIAC RHYTHM MANAGEMENT HEADQUARTERS

LOCATION
Mounds View, Minn.

BUILDING USE
Office/Research and Development

SIZE
Phase 1 to be 820,000 square feet

PARKING
Parking to accommodate phased growth

PROJECT COMMENCEMENT
Spring 2006

COMPLETION DATE

Phase 2 to bring total square footage to 1.2 million

Phase 3 to bring total square footage to 1.5 million

Fall 2007

DESIGN AND CONSTRUCTION
Opus Architects & Engineers
Julie Snow Architects
Opus Northwest, LLC. Design-Builder

- Situated on an 85-acre site located in the cities of Mounds View and Blaine, Minn., phase one of the complex features two eight-story towers that will house more than 3,200 CRM employees
- On the inside, employees will enjoy the latest office conveniences in the towers' interconnected first floor common areas, which include childcare and fitness centers, a cafeteria, coffee shop and a state-of-the-art education center for employees and physicians. A glass, seven-story, 30-foot-wide "link" connecting the towers on floors one through seven will feature fully wired conferencing areas and pedestrian walkways to enhance communication and interaction between CRM departments
- On the outside, employees can enjoy the beauty of the natural vegetation planted along a walking path that extends around the campus grounds
- This environmentally friendly facility includes sustainable design features, such as the building's east-west orientation, higher floor-to-floor heights and off-perimeter office spacing that allow greater access to natural light to save energy
- This initial project is phase one of Medtronic's plan to bring the majority of CRM's 3,800 Minnesota employees currently located at five disparate locations across the Twin Cities onto one corporate campus
- Future capacity plans – phases two and three – call for the construction of two additional towers and additional parking.

THE SCIENCE OF SETTLEMENT SUCCESS

"I don't even bother sending demand letters. The firms never pay anyway. What a waste of time…."

Have you ever heard this? Or even said it?

Many years ago, I heard these and similar statements again and again. So frequently that I began to believe it. If you say that or have said it in the past, then this article is for you. If you're new to the game and have heard that or just don't ever want to think that way, you'll benefit from this article, as well.

My thinking on this topic has changed over the years. I no longer believe that demand letters are futile because they have worked well, again and again, for my clients. It all began about ten years ago when I first started my own practice. I didn't have anyone else to proofread or edit my work and I decided to begin trusting my gut instead of listening to others' preconceived notions. I began to wonder if I actually could get decent settlements if I wrote a good enough pre-filing story.

It worked.

At first, I thought it was a fluke. I even began to question whether I was a good lawyer because I found I filed very few cases. I was settling cases, getting good results, but I had adopted the belief system of many others that settling cases was… settling for less. Even though I wasn't.

Looking back on what has worked and why, I have detected a pattern, a recipe if you will, for settlement success. It isn't just as simple as picking "good" cases. There are three key ingredients for successfully resolving cases. I share them below.

Before I do, here's a bit more about why I continued to write demand letters even when I heard the old line that they didn't work. This part is important because I didn't make a conscious decision to change my belief system. It happened rather by accident. By sharing this story with you, I am giving you a gift nobody gave me – the opportunity to do things differently with intention, not by happenstance.

I practiced primarily in a state that had a great consumer protection act that required we send a demand letter prior to filing. I didn't send demands back then because I believed they would work, I sent them because I had to if I wanted a statutory basis for attorney's fees and possibly even multiple damages in some cases. I always sent them. Just because.

Just like people said, though, they often didn't work.

We often resolved cases before hearing or trial – statistically speaking, most cases do. We went through the usual channels of:

- Useless demand
- File case
- Go through discovery and the typical unsatisfactory disputes related thereto
- Get a lowball offer (maybe)
- Scramble for a last minute mediation, maybe even postpone the hearing
- Reach mildly dissatisfactory settlement

- Move on to the next

What I have learned over the last nearly twenty years, however, is that the demand letters' lack of success was due to something other than the attitudes of those on the other side about paying claims.

It had a lot more to do with the letters themselves.

Since those early years, I've written a lot more demand letters. I've also had the pleasure to work on the inside of the insurance industry sitting on the other side of many demand letters – both useful and useless. I've settled a lot of cases without filing for 100 cents on the dollar plus attorney's fees.

Seriously.

I eventually figure out it wasn't a fluke. Only recently did I figure out the recipe in general and more particularly the secret sauce ingredient that the most compelling demand letters have in common – belief.

I'll share more on that, what it means, and how you get it later.

But in addition to the ***secret sauce***, the other two ingredients all successful demand letters have are:

1) A lot of work on the front side; and
2) Acknowledgement and a road map of what the other side needs to hear.

Let's start with the first ingredient.

1) Do the work up front

This may sound simplistic or even trite, but I know so many lawyers who try to keep expenses down when it comes to settling cases. That means not even talking to an expert, running a proper P&L, or putting together illustrations until almost time for hearing or trial. Some don't even like to ask clients to contribute to the costs of pursuing their cases, which leads to even more desire to refrain from investing in a case until the last possible minute.

gulp

"Trying" to resolve a case or just going through the motions of pre-hearing processes and negotiations based upon an assumption that the other side is never going to make an offer you'll be willing to accept sometimes means not even pulling together essential (and basic) legal research that supports the claims you are asserting (or intend to assert) down the road.

Don't do that.

Assuming that the other side *should* see your case the way you do, but is acting like they don't will not get you far. Neither will assuming that they are just out to screw you and your client. Doing so and operating from a place of such conclusions leaves them in control. If those choices and assumptions keep you from doing your own complete analysis early on, it also means they know more than you do about your case – not helpful when you do, indeed, have a great case.

Instead, by knowing what you need to know first you can take control of the process. While some believe “showing all your cards” too early will damage your case down the road by eliminating the element of surprise, the reality is that laying out a compelling argument early on increases the odds of getting a good outcome without going to hearing.

One reason for this is that the initial review of your first correspondence determines how the other side assesses your case. It is the first step of being in control of the negotiation. It determines the reserve that is set and the level of investigation that occurs. I can’t speak to brokerage firms, but in my insurance experience the more serious an incident, the higher the level of incident review. Both at the time of the incident and in response to a demand. Sometimes the other side doesn’t even know what happened to your client. Sometimes they do. The best approach is to assume they don’t and then be the one that educates them about your client, who they are, how they were wronged and why it is in everyone’s best interest to reach a resolution of the matter.

If something serious happened, it’s likely already on their radar screen. They also know how they see it, but they may not put a dollar value on it until they hear from you. Your first communication telegraphs to them what your perception of the situation is and can cast the situation in a light they hadn’t even considered. Perhaps it seems that you don’t take it seriously because your demand letter looks like a high school student wrote it as a mandatory mock trial assignment just to check a box. A student who wants to go argue the case and put the debate skills to work, but who most definitely does not want to write a boring old letter. If that’s how your work looks – like you aren’t taking this part very seriously - odds are the other side won’t be taking you very seriously (or the risk associated with your client’s case) either until you prove otherwise. That equates with wasted time on your end. Starting off with low expectations – or flat out refusing to lay out your theory of the case at all - rarely serves anybody.

And it won’t serve your client, either.

Put in the work at the outset, set the client’s expectations early, and be prepared by knowing all the ins and outs of your client’s case – even if you don’t show all the cards right away. Knowing what you need to know gives you the tools you need to have meaningful conversations and respond to points raised by the other side right from the start. It creates more opportunity for engagement, rather than dismissing pre-filing discussions as uniformly useless.

2) Tell the other side what they need to hear

And listen to what they tell *you*.…

The second part is probably the most often overlooked aspect of ingredient number 2. I’ll share more about what you need to tell the other side to get them to want to settle your case in a minute, but please listen to what they have to say to you.

Time and time again, when I was on the other side of the telephone conversations after *receiving* a demand, I would tell lawyers what I needed from them to resolve the case without them having to file. Filing a case does not increase its settlement value. It usually doesn’t negate it, either, but the more money spent on legal (as opposed to the claim itself) does not help your cause.

Often I had to stop lawyers who wanted to talk about the devastating injuries their clients had suffered to remind them that they had a major problem with liability. While I may have felt sympathetic about the injuries their clients experienced, there was little point in having further conversations if they could not demonstrate that essential liability element. Other times it would

be a lack of duty absent from a case, which is an issue that can often be pretty easily addressed with a minimal amount of research. One lawyer I remember in particular had a well-documented damages component in his case, but really needed to do some research to pin down his theory of liability. I nearly laid out what he needed to look at. I would have been able to make a very attractive offer if he had just done an hour or two of research. He chose to file suit instead and that case, to my knowledge, is still pending in court. The job of the other side is not to do your work in showing them why they should pay you. That's your job. Do *your* job.

Keep emotion out of the equation. This is a mistake many plaintiff lawyers make. While that alone will not prevent your case from settling (being nice doesn't get cases settled, but not being a jerk can make it easier to have the conversations that do get them settled), it is likely to result in you (and thereby your client) from getting the benefit of the doubt on any issue where it is required. Remember that the person on the other side isn't automatically a jerk. They could be a perfectly nice person. Assuming that they are anything other than that is not likely to get you started off on the right foot. I know plenty of lawyers who seem to go into every single conflict with an assumption that the other side has it out for them. Personally. They probably don't.

It's also possible that the individual rep isn't a total jerk, either. They may be a perfectly nice person who made an honest mistake. Or the problem your client experienced may be due to the failings of compliance or supervision and not the rep him or herself. Making assumptions about those on the other side of your case when you don't have all the information is a surefire way to break any hope of building connection. That may not sound like something we should strive for in our settlement conversations, but I invite you to think otherwise. Most demand letters do not invite building connection, singing kumbaya, or touching hands (not currently allowed anyway), but one objective that is often desirable is to invite conversation. Making assumptions that may not be correct and could be demonstrably proven otherwise is unlikely to garner any points and make it harder to find common ground. Finding common ground, even if it is just a tiny strip in the middle of two polar opposite poles, is the first step towards expanding the swath of commonality. Starting things off by pushing the other side further away does little more than deepen the divide you're ultimately trying to bridge.

An easy way to do that is to stick to the facts, the ones you can already prove (which, if you've done the work on the front side, you already know), and give the other side a reason to open the checkbook – or at least the dialogue.

Ultimately, what the other side needs to hear is pretty simple. ***They need to hear why their client or employer should pay your client.*** They need to know what went wrong, why they are responsible for it, and how much they need to pay. Emotional rhetoric is meaningless time wasters. Other non-tangible items that are good for them to know are that you are willing to put in the work, that you know your case is good, and that you are someone they are willing to talk to. Added bonus points if your conversations with them are even pleasant.

One final point… the reserve. Typically when a new claim comes in the door it will be assigned a dollar value. If you can't calculate it right now, tell them that and why. If you can calculate it, then do it and tell them your number. Playing games won't get you to that number, negotiating for it will. If you don't give them a number, they will have to decide what that number is. If they undervalue a claim and find out way down the road – months or years later – they have to adjust that number upwards. It may require a higher level of approval. They may have to answer a lot of questions for increasing it later even if it isn't a large increase. Make their job easy by giving them a good number early on so you can focus on the important substantive stuff.

3) The secret sauce – believing

The secret ingredient in settlement success is believing that it will work. Believing it matters. Believing you have a great case and that you can try that sucker if you have to and get an amazing result.

Here's where a lot of our Type A lawyer brains check out. Maybe even guffaw. But it may be the simplest way to increase settlement offers. Here's why:

If you believed your demand letter would actually result in settling your client's case for a very good amount, would you put more effort into it?

If you believed your opponent would make a reasonable offer to resolve your case, would you spend more time engaging in settlement discussions?

If you believed in your ability to try the case and get an amazing result, do you think it would impact your opponent's desire to make a higher offer to resolve the case?

See where I'm going here?

The reason our beliefs matter is because they shape everything, from the way we draft the letter and speak on the phone, to the words we choose for both of those tasks. Believing our efforts will be fruitful lead us to engaging an expert early on, putting together the charts, numbers, research we need to draft a compelling letter. It also leads us to put our best work out there early on, rather than hiding all we can until the last minute, fearful that showing most of our hand will hurt us more than it will help us.

If you don't yet believe in the power of believing, I invite you to take a look at a study conducted back in 2007 by Harvard psychologist Ellen Langer. She studied the placebo effect in the context of exercise by using an interesting study group – hotel maids. The maids walked up and down hallways, lugged heavy equipment, and burned more calories in a day at work than the US surgeon general's daily exercise recommendation. More than two thirds of the maids in the study reported at the outset that they didn't get enough exercise, roughly one third said they didn't exercise at all. They didn't believe they were fit and most of their bodies and health related statistics reflected that. Half of the maids in the group were told how many calories they were burning each day and that they were exceeding exercise recommendations; the other half were given no information at all. A month later the researchers returned to see if anything happened.

Surprisingly, the maids who were given information about the amount of exercise they were getting each day had lost weight, lowered their blood pressure by 10 points, and noticeably reduced their hip to waist ratios. The half that were not given any information had no measurable changes. They all reported making no other lifestyle changes during that month.

The conclusion? Mindset matters. A lot.

Not convinced yet? Another study on mindset, expectation, and belief involved a number of veterans who were given the option of having a regular surgical procedure for osteoarthritis of the knee or getting a "sham" pretend surgery to see if the fake surgery would provide a beneficial placebo effect. Nobody in the study group knew which surgery they were getting. Those who received the sham surgery had incisions and stitches in their knee after undergoing anesthesia, as did those who received the actual surgery.

Surprise! All but one of the patients who received the sham surgery had the same or similar outcome as the patients who had the actual surgery. The results? Lasted for two years for most of the sham surgery group.

Again, the belief matters.

There are so many studies and stories out there that support the idea that underlying belief impacts outcome way more than most of us realize. When students are told they can improve their IQ, guess what? They improve IQs.

Still not sold? Take a look at Bianca Andreescu, the 19 year-old Canadian who defeated Serena Williams at the 2019 US Open. When asked after the match what got her there, Bianca said it was her mindset. She had taken a program that helped her visualize herself winning the US Open and she just keep believing.

You probably can't visualize your own way to winning the US Open if you're not a professional tennis player, but the takeaway from her experience is that she had the tools, the training, the expertise to get there.

So do you.

You have the tools, the training, the experience to get good settlements. Do the work, tell the other side what they need to hear, and begin believing you can and will get good outcomes. Then see what happens.

The best news of all? Believing doesn't cost you a penny.

That's it, that's the magic recipe. The best part about it is we can apply so much of it to any aspect of our lives that we want to improve. Getting better outcomes with less time and effort spent on meaningless discovery disputes is (and, frankly, should be) a desirable goal for all of us. If you want to talk more about any of these aspects, I can always be found at angela@sagelegalcounsel.com. One last thought… I didn't stumble upon these ideas out of sheer luck. They were the product of a special combination of professional experience, developing self-evaluation tools, and working with coaches who taught me to pay attention and look for patterns in the world. All of that led me to seek a life coaching certification myself. If you ever want to explore how to change your own thoughts, belief patterns, and ultimately your life outcomes, please feel free to reach out to talk more.

May all your cases fulfill you and your clients and make the world a better place for us all!